MEMORANDUM OF DISCUSSION

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, April 29, 1969, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Bopp
Mr. Brimmer
Mr. Clay
Mr. Coldwell
Mr. Daane
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Scanlon

Messrs. Francis, Heflin, Hickman, and Swan, Alternate Members of the Federal Open Market Committee

Messrs. Morris, Kimbrel, and Galusha, Presidents of the Federal Reserve Banks of Boston, Atlanta, and Minneapolis, respectively

Mr. Holland, Secretary
Mr. Broida, Deputy Secretary
Messrs. Kenyon and Molony, Assistant Secretaries
Mr. Hackley, General Counsel
Mr. Brill, Economist
Messrs. Axilrod, Baughman, Eastburn, Green, Hersey, Partee, Solomon, and Tow, Associate Economists
Mr. Coombs, Special Manager, System Open Market Account

Mr. Sherman, Consultant, Board of Governors
Messrs. Coyne and Nichols, Special Assistants to the Board of Governors
Mr. Wernick, Associate Adviser, Division of Research and Statistics, Board of Governors
Mr. Keir, Assistant Adviser, Division of Research and Statistics, Board of Governors
Mr. Bernard, Special Assistant, Office of the Secretary, Board of Governors
Miss Eaton, Open Market Secretariat Assistant, Office of the Secretary, Board of Governors

Messrs. Taylor, Jones, and Craven, Senior Vice Presidents of the Federal Reserve Banks of Atlanta, St. Louis, and San Francisco, respectively
Messrs. Eisenmenger, Sternlight, and Snellings, Vice Presidents of the Federal Reserve Banks of Boston, New York, and Richmond, respectively
Mr. Davis, Adviser, Federal Reserve Bank of New York
Messrs. Geng and Shotwell, Assistant Vice Presidents of the Federal Reserve Banks of New York and Cleveland, respectively
Mr. Kareken, Economic Adviser, Federal Reserve Bank of Minneapolis

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on April 1, 1969, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee held on April 1, 1969, was accepted.

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 1 through 23, 1969, and a supplemental report covering the period April 24 through 28, 1969. Copies of these reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Coombs said the Treasury gold stock remained unchanged and gold holdings of the Stabilization Fund had now risen to nearly $570 million as a result of purchases of another $100 million from the Bank of France. In London and Zurich, the free market price of gold had fluctuated somewhat above $43--today it was $43.55--with buying pressure from France being offset by continuing South African sales. He estimated that such sales by South Africa during the first quarter of the year might have come to roughly $100 million, about one third of current output.

On the exchange markets, Mr. Coombs observed, the French franc had been weak throughout the month and France's total reserve losses had approached $600 million. The French trade figures for March showed a further deterioration and the capital flight

continued despite the controls. Against that background, there was considerable concern both here and abroad that the resignation of the French government after defeat in the referendum last Sunday might set off a new wave of speculation on a devaluation of the franc, possibly in conjunction with parity changes in the mark and other currencies. Fortunately, however, the market reaction so far had been relatively mild. Yesterday, the Bank of France lost roughly $75 million, but today it was holding even. It might be that the results of the referendum had already been rather fully reflected in reserve losses earlier in the month. Today there also seemed to be some feeling in the market that the caretaker government headed by Couve de Murville would find it difficult, if not impossible, to change the parity, thus giving the market another month or six weeks in which to hedge. More generally, the retirement of General de Gaulle might have relieved earlier fears of a breakdown in international financial cooperation and revived hopes for an orderly, gradual solution of the French financial problem. But the present situation was extremely fragile and could easily give way to renewed speculation from one day to another.

There also had been much concern that speculation on the franc might have serious side effects on sterling, Mr. Coombs continued. The sterling rate in fact plummeted by roughly 50

points at the opening on Monday but it subsequently recovered strongly and was holding around $2.3880 today. Last-minute buying by oil companies with royalty payments to make, together with month-end positioning, helped considerably to turn the situation around yesterday, and today sterling was benefiting from the easing of pressures on the franc.

More generally, Mr. Coombs said, sterling had continued to profit from the heavy seasonal earnings of the overseas sterling area countries. During the first quarter, for example, the Bank of England took in roughly $700 million, most of which was devoted to debt repayment. But during the same period the overseas sterling area countries, taking advantage of the dollar guarantee given by the British government last September, increased their balances in London by $450 million. Since the British had drawn on the Bank for International Settlements under the Second Sterling Balance Arrangement to finance earlier liquidation of the sterling balances, they now had to repay $450 million to the BIS before the end of June. In effect, much of the dollar intake of the Bank of England since the turn of the year had represented a substitution of new debt for old. The favorable seasonal influences normally ran their course during May and during the second half of this year the British would face the dual problem of an adverse seasonal trade pattern and very heavy debt amortization.

Mr. Coombs noted that the mark had risen sharply since the French referendum and during the past two days the German Federal Bank had had gross inflows of roughly $260 million. The Federal Bank had recycled the bulk of the inflows to the Euro-dollar market by providing special swap facilities. He had the impression that there was a general swing of opinion in Germany in favor of a mark revaluation as the only practicable way out. However, there was continuing insistence at the official level that such a revaluation would have to be accompanied by changes in several other currency parities and, in any event, could not be undertaken until after the September elections.

Thus, Mr. Coombs commented, a curious situation existed in the exchange markets at present. It was generally assumed that the mark would eventually have to be revalued and the French franc devalued, with a major question mark hanging over sterling. At the same time, it was still accepted that the mark parity would remain unchanged until next fall and that no action would be taken on the French franc for another month or six weeks. That paradoxical situation was unlikely to last very long; the first signal of a shift in official intentions regarding the parity relationships of the mark and franc could set off another massive wave of hedging such as had occurred last November. In

the interim there was little that central banks could do except to honor their commitments while awaiting political developments. It was to be hoped that issues relating to international financial matters would be dealt with discreetly in the coming French election campaign.

By unanimous vote, the System open market transactions in foreign currencies during the period April 1 through 28, 1969, were approved, ratified, and confirmed.

Chairman Martin then invited Mr. Daane to report to the Committee on developments at the April Basle meeting.

Mr. Daane remarked that the discussion at the Governors' sessions in the afternoon and evening of April 13 had focused primarily on developments in the Euro-dollar market. The Governors were unanimously of the view that the restrictive stance of U. S. monetary policy, while the source of the difficulties in the Euro-dollar market, was both necessary and desirable. At the same time, considerable concern was expressed about interest rate developments and about the defensive measures that had been required in some countries, and several of the Governors raised the question of whether there were any actions the System could take to alleviate the situation. However, attitudes on the matter were still mixed. The Belgians were the most vocal in expressing concern; evidently the Euro-dollar situation posed a problem with

respect to their domestic budgetary financing. Others, including the Germans, indicated that Euro-dollar developments had been helpful domestically in facilitating moves in the direction of monetary restraint.

Mr. Daane added that the matter had been discussed further at the meeting of Working Party 3 in Paris this past week. He understood that Mr. Solomon would comment on that meeting later today.

In response to an inquiry by the Chairman, Mr. Coombs remarked that his recommendations were confined to those contained in his memorandum of April 22, 1969, entitled "Renewal of swap drawings by the Bank of England and the Bank of France."[1/] In brief, he recommended renewal of a number of drawings by those Banks that would mature soon, if requested by the other party. The drawings in question were listed in the table on the first page of the memorandum; they consisted of seven by the Bank of England, totaling $800 million and maturing in the period May 20-June 4, 1969,[2/] and four by the Bank of France, totaling $281 million and maturing May 19-20.

1/ A related background memorandum by the Board's staff, entitled "Bank of England and Bank of France swap debt to the Federal Reserve System," was distributed on April 23, 1969. Copies of both memoranda have been placed in the Committee's files.

2/ As a result of an error in transcription, the last of the seven Bank of England drawings referred to--a $50 million drawing maturing June 4, 1969--was incorrectly shown twice in the table.

As indicated in his memorandum, Mr. Coombs continued, the swap line with the Bank of England had been in continuous use since July 1, 1968 and that with the Bank of France since June 5, 1968. Accordingly, renewal of the drawings for further three-month periods would require special authorization by the Committee, under the provisions of paragraph 1D of the authorization for System foreign currency operations. That paragraph, Mr. Coombs said, provided that the swap lines should be fully liquidated after one year of continuous use unless the Committee, because of exceptional circumstances, specifically authorized a delay.

It was highly unlikely that the British would experience an inflow of dollars that would enable them to repay all outstanding drawings by June 30, Mr. Coombs remarked. Moreover, on the basis of discreet inquiries he had concluded that there was no possiblity of repayment through funding operations under which the U. S. Treasury, the IMF, or foreign central banks would take over the British debts to the System. Accordingly, he thought there was no practicable alternative to renewal of the drawings. There was some possibility that the Bank of France would be able to repay its drawings in May and June with funds borrowed from other central banks under the credits arranged at the Bonn conference in November 1968. Whether or not that proved feasible

would depend on developments; the chances would be reduced if there were a new wave of speculation against the franc during the coming election campaign.

Mr. Coombs then said he might add some comments on a point not covered in his memorandum of April 22. The language of paragraph 1D of the foreign currency authorization was originally adopted by the Committee in May 1963 in an amendment to a predecessor instrument--the "Guidelines" for System foreign currency operations. At the time of that action Mr. Shepardson had expressed concern about a process he had described as "leapfrogging"--under which a party to a swap arrangement would make new drawings for the purpose of repaying earlier drawings--with the result that credits under the swap line could in fact be of a medium-term rather than of a short-term nature. He (Mr. Coombs) thought that neither the Bank of England nor the Bank of France could be charged with "leapfrogging" operations if they requested renewal of the present drawings, since there had been two separate waves of speculation against both the pound and the franc--the first in late spring and early summer of 1968, and the second at the time of the November crisis.

Mr. Robertson said he concurred in Mr. Coombs' recommendations. The need to renew the British drawings was clear, since no alternative means of financing were available to them.

The French did have the alternative of drawing on the IMF, but in view of the existing political situation in France he thought it would be unrealistic to press them to take that step at the moment. At the same time, he thought it would be desirable to discuss with the U. S. Treasury the general question of the appropriate roles of the System and the Treasury in connection with central bank debts that were running on for longer terms.

In response to a question by Mr. Mitchell, Mr. Solomon noted that details of French use of their swap line with the System were contained in Appendix V to the Board staff's memorandum. Briefly, from June through September 1968 the French had drawn a total of $450 million. They had repaid $75 million in October, drawn $196 million in November, and repaid $278 million in December and January. Subsequently, they had drawn $168 million in February and March and repaid $25 million thus far in April.

Mr. Solomon then observed that the pattern of alternating drawings and repayments did not imply an intent on the part of the Bank of France to engage in leapfrogging operations. There had been no requirement for the French to make repayments in September, December, and January, since their total drawings had remained well within the leeway allowed under the swap arrangement. It seemed clear that they should not be penalized as a consequence of those repayments.

Mr. Mitchell remarked that he was prepared to approve Mr. Coombs' recommendation on the British drawings. However, he did not think the French should be permitted to draw continuously on the swap line for more than a year. The System found itself in an unfortunate situation with respect to the British as a result of an unduly tolerant attitude earlier, and he would not want to repeat that mistake in the case of the French.

Mr. Coldwell commented that he was concerned about the System's continuing exposure in connection with large credits to the British. If the Committee were to make an exception to the one-year rule at this time it might be desirable to do so only on the condition that any further renewals by the British would come under close surveillance, to be maintained as long as the line was in continuous use for more than a year. His concern focused not so much on the question of leapfrogging as on the fact that the swap lines were intended to offer short-run accommodation for dealing with reversible market situations. The staff memorandum noted that a large volume of individual British drawings would have been outstanding for a full year in November 1969. Since it was quite possible that the British would again be requesting large renewals then, he thought it particularly important to consider whether a condition should be attached to any present renewals.

Mr. Daane said he concurred in Mr. Coombs' view that there was no practicable alternative to renewing the swap drawings in question, and he did not think any useful purpose would be served by attaching conditions in the case of the British. He added that, as Mr. Coombs' memorandum noted, the British might soon make a new drawing on the IMF and use part of the proceeds to pay down their debt to the System.

Mr. Mitchell observed that it might be desirable for the Committee to face up to the fact that the British debt represented a frozen asset, and agree to fund it by increasing System holdings of guaranteed sterling.

Mr. Coombs responded that in his judgment it would be less desirable to fund the debt by that means than to renew it on a short-term basis. As to Mr. Coldwell's suggestion, he (Mr. Coombs) thought a case could be made under particular circumstances for attaching conditions to use of swap lines; indeed, he had offered a similar suggestion last May in connection with the British swap line. However, he thought there was less to be gained by such a course under the circumstances of the moment than at times in the past.

Chairman Martin observed that in a recent lengthy discussion with the Managing Director of the Fund he had learned that the IMF was putting a substantial amount of pressure on

the British. He (the Chairman) thought the Fund was an appropriate source of such pressure, and that additional pressure from the System at this time would serve little purpose.

Mr. Hickman commented that he would favor the course Mr. Robertson had recommended--namely, agreeing to renewal of the drawings in question on the understanding that discussions would be undertaken with the U. S. Treasury about possibilities for funding the French and British swap debts to the System.

Mr. Brimmer asked whether the possibility of an intermediate course was not implied by the Board staff's memorandum. He had in mind the passage which read as follows:

> "Although the British swap line will have been in continuous use for one year on July 1, 1969, the first drawing presently outstanding to reach its one-year limit is a $50 million drawing which will be one year old on September 4, 1969. Another $50 million drawing will be one year old on September 9, 1969. If the British can acquire the $100 million to repay these drawings on their first anniversary, then their problem of acquiring funds to reverse the remaining outstanding drawings will be deferred until late November 1969, when $750 million of drawings reaches the one-year limit."

If possible, Mr. Brimmer continued, it would be desirable, in his judgment, to maintain the one-year limit while buying time for discussions with the Treasury with respect to procedures for the longer run. He personally would attach great weight to the

desirability of avoiding continuous use of the swap lines for more than a year. And, as he had indicated on a number of occasions recently, he had hoped that discussions with the Treasury would be in process by this time.

Mr. Coombs observed that he had held some discussions of the matter with Treasury officials, but with little result. He added that the "intermediate course" to which Mr. Brimmer had referred would not relieve the Committee of the necessity for deciding today whether there were special circumstances that warranted authorizing renewal of the French and British drawings that would mature shortly, since further three-month periods for those drawings would mean that the respective swap lines would be in continuous use for more than a year. He could not forecast the situation that would be prevailing in November; while he hoped that no individual swap drawings would remain outstanding for more than a year, he was not optimistic about the British case in view of the heavy debt repayments they faced.

Mr. Brimmer said the basis for his earlier comments was his belief that the System should indicate somewhat greater reluctance to renew the swap drawings in question at this time.

Mr. Daane observed that he did not share Mr. Brimmer's view; as Chairman Martin had indicated, the IMF already was

placing a good deal of pressure on the British. He agreed that it would be desirable to continue discussions with the Treasury, although he did not think the prospects were good that the Treasury would be prepared to take over the British debts in the near future.

Mr. Brimmer then suggested that it would be helpful to have the views of the Board's staff.

Mr. Solomon observed that the position the Board's staff had taken in its memorandum was not essentially different from that of Mr. Coombs. He (Mr. Solomon) thought the Committee could justify permitting the two swap lines in question to remain in continuous use for more than a year on the grounds that exceptional circumstances made it desirable to interpret the one-year limit in the present instances as applying to individual swap drawings. He certainly agreed with Mr. Coombs that when individual British drawings reached the end of one-year terms next November the British might not be in a position to repay them. However, the Committee did not have to decide today what course of action it would follow in November if that should prove to be the case.

Chairman Martin said he thought that there was no practicable alternative to renewing the maturing swap drawings, but that, as Mr. Robertson had suggested, discussions should be pursued with the Treasury.

Mr. Hayes commented that he shared the views expressed by Chairman Martin and Mr. Daane.

Mr. Coldwell asked whether the Committee would not be making a change in policy if it abrogated the one-year rule.

Chairman Martin remarked that the Committee clearly had no alternative to authorizing renewal of the drawings in question unless it were prepared to turn its back on the other parties involved.

Mr. Hayes said he did not think the Committee would be abandoning its general position regarding the short-term character of swap drawings; rather it would be making an exception to the one-year rule in light of special circumstances.

Mr. Coombs noted that paragraph 1D of the foreign currency authorization specifically provided for delays beyond one year in liquidating drawings on swap lines when the Committee thought exceptional circumstances justified such a course.

Mr. Mitchell commented that he planned to vote against authorizing renewal of the maturing swap drawings by the Bank of France, and thus permit their continuous use of the swap line for more than one year. As he had indicated earlier, he thought the System had followed a mistaken course in connection with drawings by the Bank of England, and he wanted the record to show that he

opposed a repetition of that mistake in connection with French drawings. One possible alternative course--noted in the staff memorandum in connection with the British debt to the System--would be to ask the Congress for an appropriation that would permit the Treasury to refund such debts on a long-term basis.

Mr. Brimmer said he planned to vote against authorizing renewal of the maturing drawings by both the Banks of England and France. In his judgment there was a practicable alternative to renewal--to have the Treasury take over the British and French debts to the System.

After Mr. Solomon noted that Mr. Brimmer's statement seemed inconsistent with the latter's earlier suggestion that an intermediate course be followed, Mr. Brimmer remarked that on further thought he had modified his position. At some point the System had to call a halt and turn to the Treasury.

Mr. Maisel remarked that he was inclined to agree with Mr. Brimmer on the principle at issue; indeed, on earlier occasions he had advanced a related argument to the effect that the Treasury should be asked to take the responsibility, either directly or by requesting Congressional action, when swap drawings became intermediate-term credit. Having failed to persuade the Committee on those occasions, however, he was prepared to vote favorably on Mr. Coombs' recommendation today.

Mr. Coldwell observed that while he planned to vote favorably on the recommendations he would do so with reluctance in view of his concern with the System's exposure.

> With Messrs. Brimmer and Mitchell dissenting, renewal for further periods of three months, if requested, of the four swap drawings by the Bank of France maturing in the period May 19-20, 1969, and totaling $281 million, was authorized.

> With Mr. Brimmer dissenting, renewal for further periods of three months, if requested, of the seven swap drawings by the Bank of England maturing in the period May 20-June 4, 1969, and totaling $800 million, was authorized.

Chairman Martin then remarked that he would say a few words about the annual meeting in Williamsburg of the Governors of Central Banks of the Western Hemisphere that had begun with a dinner on Saturday (April 26). On the whole, he thought the meeting had been successful and quite worthwhile. He was particularly pleased that three Reserve Bank Presidents--Messrs. Coldwell, Hayes, and Heflin--had been able to be present at the opening dinner, as well as all members of the Board except Mr. Daane, who was abroad. Mr. Heflin had been helpful in connection with the arrangements for the meeting. His own function

as Chairman had been made particularly pleasant by the willingness of participants to enter into the discussions. There was a marked difference in that respect from the first such meeting held a number of years ago in Antigua--a difference which was attributable in good part to Mr. Mitchell's enthusiastic approach to the project.

The Chairman then said that he wanted to thank all of the System people who had helped make the meeting a success. He knew that their efforts had been appreciated by all participants.

Mr. Hayes added that he thought Mr. Martin should be commended for the effective manner in which he had chaired the meeting.

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 domestic open market operations for the period April 1 through 23, 1969, and a supplemental report covering April 24 through 28, 1969. Copies of both reports have been placed in the files of the Committee.

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

> Financial markets in the past several weeks have experienced a somewhat unusual aftermath to the further restrictive steps announced by the System near the beginning of the interval--namely, the one-half percentage

point increases in discount rates and in reserve requirements against demand deposits. In contemplating appropriate open market operations to accompany these moves, there seemed to be a fairly widespread feeling in early April that such operations might have to "cushion the blow" somewhat so that markets would not be jolted too severely. One widely read market commentary headlined its report on these actions as the "end of gradualism" and many observers shared this sentiment.

In fact, however, the market's reaction to the System's overt moves was notably mild--so much so that open market operations, in order to preserve and underscore the intended tone of restraint in the market, shaded toward the firmer side with respect to day-to-day conditions. This tendency was reinforced as the period went along, as increasing evidence became available of stronger-than-expected growth in bank credit. Given the volatility of recent month-to-month changes in total member bank deposits--the credit proxy--the proviso clause of the April 1 directive was activated only marginally and tentatively at first. But as additional weekly data confirmed the evidence of excessive growth--even after making some allowance for the effect of certain statistical peculiarities around the Easter weekend--increasing weight was placed on the proviso.

The impact of this policy approach was most readily visible in the day-to-day Federal funds rate. Where the expectation at the time of the last meeting had been that funds would range around 7 per cent or somewhat above, the recent range of effective rates has been 6-3/4 to 7-7/8 per cent--and typically anchored to the high side of 7 per cent. Funds traded at high rates on a number of days about midway in the period when a low point in Treasury cash before the mid-April tax date and System action to mop up reserves through matched sale-purchase transactions produced a lopsided distribution of reserves. But high funds rates have been permitted to return again in the last few days of the interval, although reserves have been more evenly distributed, as greater strength in bank credit has become evident.

The markets in intermediate- and longer-term fixed income securities have shown surprising strength recently in the face of more evident determination to proceed with monetary restraint. One reason for this strength--which has seen prices on long-term Treasury, municipal, and

corporate issues rise several points--is the belief that real progress will be made soon in de-escalating the Vietnam war. It is a hope we can all share fervently but one that we cannot comment on knowledgeably. Another reason for the firm bond markets during the period was the conviction that because the authorities are now even more vigorously engaged in combatting inflation, chances of success are better assured and there is a better likelihood that interest rates will decline over the long pull. This also is a difficult factor to appraise, but I wonder if the adherents to this view are not making too quick a leap from the strong determination of the authorities to combat inflation to the achievement of that objective. It seems to me that in getting from "here" to "there" there could be some more painful times ahead for the bond markets. But at the moment a number of market participants seem inclined to shrug off these considerations, some even to the extent of taking speculative positions in bonds. Others in the market take a more cautious and restrained view, in some cases because they feel that high costs of day-to-day financing could offset the effect of eventual price advances for longer-term holdings even if interest rates are now at or near their peaks. To the extent that greater fiscal restraint is in prospect, there would seem to be better-founded optimism about the future of bond prices, but here too the prospects seem uncertain as we contemplate possible suspension of the investment credit on one side but also a possible reduction in the tax surcharge. The primary dealers in Treasury securities have followed a fairly cautious approach thus far and generally have refrained from building inventories of intermediate- or longer-term issues, although some may be awaiting the forthcoming refunding as an opportunity to stock up.

This is the cloudy background against which the Treasury will announce its financing terms, probably tomorrow afternoon. The prevalent market expectation is that the Treasury will offer holders of May and June maturities an exchange into a note in the 6- to 7-year area and a shorter-term option in the 15- to 21-month area. Rates in the range of 6-1/4 to 6-3/8 per cent, or perhaps a shade higher, appear to be needed. Public holdings of the May and June issues amount to nearly $6 billion, so there is an opportunity to achieve some useful debt extension if the offerings are well received,

but also a vulnerability to considerable attrition if the reception is no better than for the last quarterly refunding. There has also been some market discussion of the possibility of pre-refunding the heavy October 1, 1969, maturity, of which $5.5 billion is held by the public.

The System holds $511 million of the May and June maturities and $319 million of the October's. If the Treasury presents a choice of two options, the Account Management would propose to exchange the System's holdings about in proportion with anticipated takings by the public.

The market in Treasury bills has been subject to diverse and offsetting influences in the past several weeks, and this may well continue in the weeks to come. Rates rose briefly in the immediate aftermath of the discount rate and reserve requirement moves, and also increased in the mid-month tax period when many banks sold off recent awards of "strip" bills and dealers faced higher financing costs. But during much of the period there was persistent investor demand from a variety of sources that succeeded in erasing all or most of the rate increase effects just noted. In yesterday's bidding, average rates of 6.05 and 6.04 per cent for the 3- and 6-month bills, respectively, were down 1 and 9 basis points from four weeks earlier.

Looking ahead, good investor demand for bills may well continue, bolstered by the prospective reinvestment of attrition money from the May refunding and prospective reinvestment of part of the June coupon-issue maturity and the June tax-bill maturity. On the other side, a persistence of high Federal funds rates and related high dealer financing costs could serve to limit the potential decline in bill rates, although some dip from current levels could not be ruled out. A decline to levels that would permit significant creation of new CD's does not seem likely, however.

Finally, I would like to call to the Committee's attention the recent formation of an association of primary dealers in U. S. Government securities. The purpose of the new association is to promote high standards of conduct in the industry, to serve as a medium for considering problems of common concern to the dealers, and to serve as a channel of communication--but not the exclusive channel--between the primary dealers and the Treasury and Federal Reserve. The association was

developed at the initiative of the dealers, against a background of encouragement from the Federal Reserve and Treasury. At present the association includes 21 of the 22 dealers that are now on the list of those reporting daily position, trading, and financing statistics to the System--including all the dealers with which the Desk has a trading relationship.

Mr. Mitchell referred to the sentence in the first paragraph of the draft directive[1/] which read: "In the first quarter of the year bank credit changed little on average and the money supply grew at a sharply reduced rate, but in early April both measures increased substantially, partly as a result of temporary factors." He recalled that in a discussion of the causes of the bulge in demand deposits in early April at a meeting of the Board a few days ago, staff members had suggested that certain temporary developments over the Easter weekend provided part of the explanation. He asked for Mr. Sternlight's views on the subject.

Mr. Sternlight replied that the developments were so recent that it was difficult to appraise them with any degree of certainty. His first impression had been that special and temporary factors rather fully explained the early-April bulge in demand deposits. However, the more recent behavior of such deposits had raised the possibility that something more than temporary influences might also be at work.

1/ The draft directive submitted by the staff for consideration by the Committee is appended to this memorandum as Attachment A.

Mr. Mitchell inquired whether such an expansion in bank deposits was consistent with the Committee's objective of limiting growth in bank credit. His question, he noted, was not meant as a criticism of recent Desk operations. He was trying to determine how likely a self-reversal of the deposit bulge was considered to be.

Mr. Sternlight replied that if such expansion persisted it would probably not be consistent with the Committee's objective. As he had noted in his prepared statement, information concerning the bulge in deposits had become available only gradually in the period since the previous meeting. Early in the month the Desk had begun to obtain some indications that growth in bank credit might be more rapid than was expected at the time of the last meeting. However, since the deposit series were so volatile--as evidenced by the swing in the proxy series from a decline at an annual rate of 6 to 7 per cent in March to an increase of comparable magnitude in April--the Desk had hesitated to move to a vigorous implementation of the proviso clause on the basis of the initial information. When subsequent evidence tended to confirm the large size of the April bulge, the proviso was implemented more actively. He still did not have a full explanation

of the bulge, but as noted in the blue book,[1] the Board staff expected a reversal in May if the money market conditions prevailing recently were maintained.

Mr. Maisel noted that the proviso clause was expressed in terms of bank credit and not money supply, and that the level of the bank credit proxy at the end of April currently was expected to be considerably below the level projected at the time of the Committee's previous meeting. Since he thought the basic issue was whether bank credit was at the level the Committee had desired, he would not consider a temporary bulge in private demand deposits to be a particularly relevant consideration.

Mr. Mitchell remarked that he was trying to establish whether the deposit increase in early April was a temporary aberration or likely to be sustained.

1/ The report "Money Market and Reserve Relationsips," prepared for the Committee by the Board's staff. The passage referred to read as follows: "The sharp average annual rates of expansion in money supply and the bank credit proxy for April are not likely to be repeated in May--and some reversal could develop--given prevailing money market conditions. These conditions can be taken to comprise a Federal funds rate generally fluctuating in a 7 - 7-3/4 per cent range, member bank borrowings $900 million to $1.2 billion, and net borrowed reserves $800 million to $1 billion. The 3-month Treasury bill may fluctuate in a 5.90 - 6.20 per cent range.... The bank credit proxy (including Euro-dollars) may decline in May in a 2 - 5 per cent, annual rate, range."

Mr. Morris observed that a significant portion of the recent increase in bank credit had taken the form of a rise in security loans. He wondered how much was known about that rise and how long it was likely to last.

Mr. Sternlight replied that part of the rise reflected an increase in loans to Government securities dealers, who had been absorbing bank sales of Treasury bills in the period around the mid-month tax date. Such loans had been worked down more recently.

In response to another question by Mr. Mitchell, Mr. Sternlight indicated that dealer holdings of Treasury coupon issues had not changed significantly in recent weeks.

Chairman Martin said he wanted to warn the Committee, as he had at other recent meetings, about the dangers of relying too heavily on projections and thus succumbing to "statisticitis." It was important that members exercise their own judgment about the outlook in arriving at policy decisions. Recent history amply demonstrated the risks of treating too literally projections given in the green book[1/] or blue book.

Mr. Robertson remarked that the statement in the draft directive indicating the bulge in bank credit and money in early April was "partly" temporary implied that part was expected

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

to be permanent. Since it appeared that the factors underlying the bulge were not fully understood, he thought a rewording of the statement would be desirable.

Mr. Holland said the language in the draft directive reflected the staff's considered judgment that technical factors were involved in the deposit bulge but that there also were some demand factors at work. Preliminary weekly money supply data reported in the blue book indicated, for example, that a complete reversal from the early April bulge had not occurred as of the statement week ending April 23.[1/]

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period April 1 through 28, 1969, were approved, ratified, and confirmed.

The Chairman 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.

1/ The weekly money supply data in the blue book for the period in question were as follows:

March 26		$194.6	billion
April 2		195.2	"
9	p	198.0	"
16	p	196.4	"
23	p	196.1	"

Mr. Brill made the following statement concerning economic developments:

After vigorous monetary restraint has been in force for several months, it is only natural to seek earnestly for some signs that this restraint is beginning to bite into the economy. And it is only natural to be disappointed at the scant evidence of slowing revealed in the recent and current statistics. Our inflationary problem is stubborn and persistent. The pace of advance in real activity, while modest in terms of the longer-run growth potential of the economy, is still too rapid for the current balance of resource availability and demands, and prices are still rising rapidly.

Nevertheless, there are some grounds for encouragement in the prospective situation, leading to a counsel of patience but perseverance in the application of monetary restraint. As I noted a moment ago, this encouragement does not stem from the recent performance of the economy. Private domestic final demands soared in the first quarter, and it was largely a slowing in the inventory build-up, coupled with the effects of the dock strike on net exports, that kept growth in total GNP from rebounding sharply.

The official but still preliminary figures on first-quarter GNP, released at about mid-month, do indicate a slight slackening in the rate of real economic growth, but these estimates were put together before the March statistics on net exports and inventories were in hand. Foreign trade data now available indicate a more rapid unwinding of dock strike effects than had been anticipated, and indications are that the net export component of GNP will have to be revised upward. March inventory data are still not available. For a variety of technical reasons, the experts here and at the Office of Business Economics do not expect much, if any, upward revision from the preliminary estimates. Nevertheless, it would not take much upward adjustment in any of the components to wipe out what now is shown as a slight decline in the

pace of real economic activity, and thereby to wipe out any mild satisfaction we might be led to feel from the effects of restoring monetary restraint last winter.

If there is any encouragement in the picture, it is not in current economic performance so much as in the few clues we have with respect to prospective performance of those elements of the economy that recently have been pressing hardest on resource availability. The principal element has been business spending for fixed capital, which has been advancing at about a 20 per cent annual rate since last fall. Business plans for capital spending over the balance of this year must be pretty well jelled by now; the earlier survey indicating a rise of about 14 per cent, year over year, is substantially confirmed by the more recent McGraw-Hill survey. Given the surge in actual spending in the first quarter, further increases in spending over the balance of the year should be small; in real terms, the increases would be negligible.

Moreover, these spending plans were formulated in an atmosphere of greater confidence about the availability of financing and prior to the Administration's request for repeal of the investment tax credit. The business community may well be taking monetary policy a bit more seriously now, and if repeal of the tax credit has any effect on spending this year, it would likely be to dampen it. With the effective cost of capital significantly higher, reflecting both higher borrowing costs and the proposed change in tax treatment, and with a margin of excess capacity available in many industries--despite folklore to the contrary--it seems to me fair to assume that the tempo of the business investment boom, a major contributor to recent inflationary pressures, is going to be much more muted from here on out.

Turning to another key element, consumer spending, the rebound in the first quarter was not entirely unexpected, although it carried somewhat further than earlier projections. It was not fueled by a surge in incomes, as was the case a year ago when both personal and disposable incomes advanced at an annual rate of over 10 per cent. This past quarter, disposable income rose at only a 4 per cent rate in nominal

terms--at a rate of less than 0.5 per cent in terms of real purchasing power--and maintenance of the rise in consumption required a significant drop in the saving rate, down to levels we haven't seen since 1965 before the Vietnam war heated up. Some rebound in disposable income growth is in prospect, particularly at mid-year when the Federal pay raise becomes effective. But by and large, with some upcreep in unemployment for two successive months now, with the work-week drifting off, with some edging down in the rate of advance in hourly earnings, and with growth in employment expected to moderate, increases in incomes available for spending are likely to be moderate. And with the saving rate already on the low side of recent experience, the safest prediction would seem to be for sustained strength but not overexuberant growth in consumer demands.

Turning to an area that has been a principal cause of instability in the past, Government spending, the fiscal posture for the remainder of this year is more encouraging now--if the program proposed by the Administration is carried through by the Congress. You will recall that, earlier in the year, the staff was concerned by prospects of the budget on a national income accounts basis slipping back into deficit after midyear, given the patterns projected in the January budget for Government spending and revenues. But the hold-down on spending increases now contemplated and the higher revenues projected to accrue from the faster pace of GNP are expected to keep the NIA budget in surplus--perhaps in the order of $6 billion--in the second half of the year.

We have been burned so often in the past by projections of fiscal moderation that some skepticism now is understandable. The temper of the Administration and the Congress suggests, however, that some progress toward fiscal restraint will indeed be maintained during these critical quarters, although the impact may be diluted later in the year by the commitment to reduce the surcharge at year-end.

Finally, the housing area seems at last to be performing according to projections, with an initial surge in starts early in the year followed by two successive months of large declines. Given maintenance

of monetary restraint, we see no reason to modify our expectation of an erratic downtrend in housing activity and expenditures, not of the 1966 pace or extent, but still of some significance in terms of the effect on aggregate demands.

If these prospects for the key elements of activity are realized, the pace of real growth would drop further to levels that should dampen the rise in costs and prices. The cooling-off process would probably continue to be agonizingly slow, but it would be a pace that should permit a relatively smooth economic adjustment.

This seems to me a legitimate target for policy. Gradualism in policy, however, cannot guarantee a gradual response from the economy. Somehow, I can't shake the feeling that the future is likely to be marked by shifts in the course of the economy as abrupt as in the past. The weight of combined fiscal and monetary restraint could, for example, puncture inflationary expectations sooner than we now expect, with significant consequences for the private economy's spending propensities and the degree of tension in financial markets. Alternatively, a marked change in the level of hostilities in Asia--in either direction--could touch off a domestic buying wave and an outburst on the price front. But the strategy of policy requires playing the best odds, not the outside chance, and I think the course we're on is the safest. I hope the System can stick to it and not be goaded by the more vociferous market observers or tunnel-vision analysts into unnecessarily intensifying the degree of monetary restraint, or seduced into premature relaxation by the faintest sign of economic cooling or extravagant promises of support on the fiscal front.

Mr. Partee made the following statement regarding financial developments:

The looseness of the linkages among financial variables, at least in the short run, was vividly illustrated by the developments of the past month. Although the Federal Reserve on April 3 announced what were generally thought to be important new monetary actions of a restrictive character, bond markets

subsequently rallied substantially in price as investors re-entered such markets in volume. And although money market conditions, as reflected in day-to-day money rates, funds flows, and member bank borrowings, have been appreciably tighter during April than earlier in the year, the banking aggregates have expanded considerably more this month than was projected at the Committee's last meeting.

Given these unexpected developments, one may wonder whether the financial markets are signaling something new about the economy, and whether another notch of tightening in monetary policy is needed to counteract what has been happening. The answer to both questions, I believe, is negative. The recent strength in both the bond markets and in bank credit seems to me to reflect the temporary factors that are unlikely to be repeated in the period ahead. The more fundamental trend is toward growing constraint in terms of the cost and availability of credit, the gradual evolution of which appears entirely appropriate to the immediate economic outlook as outlined by Mr. Brill. It is hard to say at this point how far this restraint should go or how long it should be pursued, but there is nothing in the situation as of now to indicate the need for any modification in the System's basic policy.

Indeed, some say that the marked improvement in bond investor sentiment reflects a growing consensus that fiscal and monetary restraints _will_ work and that inflationary pressures in time are bound to be dampened. This view may well have colored investor attitudes recently, since it is also the consensus that interest rates are historically very high and that the opportunity to capture these yields in portfolio will not last forever. The urgency of the timing problem for investors is heightened by the possibility of some major peace break-through in Vietnam, rumors about which have also been a feature of the past month or so.

Despite these positive psychological factors encouraging investment commitments, I am inclined to feel that the bond markets still have some rocky road to travel. The decline in interest rates this month has brought forth a very large volume of new issues, including offerings postponed earlier. Some backing off from this exceptional volume is to be expected but, looking ahead,

capital financing needs in both the corporate and municipal areas clearly remain very heavy. Meanwhile, investors have had available for commitment not only their current flows but also funds withheld from the market earlier this year. As the backlog in commitable funds is used up, and assuming that new bond offerings continue relatively large, a renewed upward trend in yields would seem the most probable outcome. Indeed, some of this already appears to be in process; the rally has run out of steam and some price markdowns have occurred in recent days.

As for the surge in bank credit, preliminary estimates now indicate a rise in April of about 7 per cent, annual rate, both in the daily-average proxy series (including Euro-dollars) and in the end-of-month loans and investments figures. The increase was attributable in part to larger average bank holdings of Governments and securities loans, partly reflecting the Treasury bill-strip financing at the end of March. But much more important in the expansion was the very strong upsurge in business financing needs over the mid-April tax date. Such needs were reflected not only in unusually heavy direct borrowings from the banks, but also in increased bank lending to finance companies and securities dealers.

Staff estimates indicate a much larger total for corporate tax payments than for tax accruals on profits in the second quarter, mainly because two payment dates--April and June--fall within the quarter and call for an increasing proportion of the year's corporate tax total. Otherwise, there is nothing to indicate an appreciable further rise in external financing needs. Similarly, no additional Treasury cash financing is expected this quarter; indeed, debt repayment and attrition on refundings may total about $11 billion. Thus, there is no reason to expect a further surge in bank credit, at least before mid-June, and some liquidation of the April increase would appear probable.

The April increase in bank credit was accompanied by an upsurge in demand deposits, and the money supply is now indicated to have increased on average this month at an astounding 15 per cent annual rate. Again, however, special factors appear to account for most of this increase. First, the four-day Easter weekend in Europe had the effect of sharply reducing cash items in process of collection at the New York banks, and hence increasing

net demand deposit totals, though only for a short period of time. Second, there appears to have been an unusually large buildup in private cash balances just prior to the tax date, reflecting the larger tax liabilities to be paid by both corporations and individuals this year. Business tax financing at the banks was exceptionally heavy, as noted, and there was a sharp rundown in individual savings balances at the banks and also apparently at thrift institutions in the days leading up to mid-April. But this buildup also should be unwinding with the presentation of tax checks in the latter part of April and perhaps on into May. I can see no reason for a more fundamental increase in the public's demand for cash balances, with interest rates remaining high, the stock market relatively calm, and transactions needs, if anything, expanding somewhat less rapidly than during the winter.

On balance, therefore, I conclude that the April developments in bond markets, bank credit, and money supply do not call for any special recognition in terms of modifying the thrust of monetary policy. They all seem attributable to special factors, and all are likely to be reversed shortly. The imminent major Treasury refunding, in any event, dictates an even keel policy for most of the period until the next meeting of the Committee.

It might be noted, however, that the money market conditions to be maintained are historically very restrictive ones. With Federal funds averaging well above 7 per cent and member bank borrowings around $1 billion or more, we would expect continuing pressure on bank reserve positions and some decline on average in the bank credit proxy next month. I think that the decline projected--2 to 5 per cent, annual rate--would be an entirely appropriate outcome, and should be welcomed as an offset to the unexpected April expansion. It seems to me important also that the bill rate be held up within the 5.90 - 6.20 per cent range specified, even if this should require a somewhat more restrictive reserve position than now contemplated. This would help to guard against a resurgence of bank credit again in June, and to prevent any public misconstruction of System policy as the large April monetary aggregates become more generally known.

In reply to a question by Mr. Mitchell, Mr. Partee said he personally thought it was highly likely that the April bulge in the monetary aggregates would prove largely self-reversing. The pattern of movement in weekly data around the tax date--which was particularly marked in the figures for country banks--lent strong support to the view that the bulge was related to needs for cash to pay income taxes, and that private cash balances would decline again as the Treasury cleared the checks involved.

Mr. Solomon said most of his remarks today would be concerned with developments at the meeting of Working Party 3 last week, but he would first make a few comments about recent balance of payments developments. There was not much one could say about recent U. S. trade developments, since the data were substantially affected by the U. S. dock strike. In particular, not much emphasis could be placed on the improvement in the trade balance recorded for March. As the green book indicated, however, the trade balance was likely to move into a substantial surplus in the second quarter with the unwinding of the effects of the dock strike. With respect to the over-all payments balance on the liquidity basis, a large deficit--of $1-3/4 billion--had been incurred in the first quarter. It was not clear what interpretation

the public would put on that development when the figures were published. Apparently another large deficit was being incurred on the liquidity basis in April. On the official settlements basis, there was a surplus of $1 billion in the first quarter and evidently a further surplus in April.

The shift in the liquidity balance from surplus in the fourth quarter to deficit in the first seemed to be primarily attributable to two factors, Mr. Solomon continued. The first was the recent deficit in the trade accounts associated with the dock strike. The second was a large outflow of direct investment capital, reversing in part the net inflow of the fourth quarter. It was possible that some U. S. corporations were returning funds to Europe as a result of the attractive rates in the Euro-dollar market, although the outflow might have occurred in any event.

Mr. Solomon then made the following statement:

> Last week's meeting of Working Party 3 focused on two related subjects: (1) the pull of tight money in the United States on the Euro-dollar market and the repercussions on interest rates, financial conditions, and reserves in other countries and (2) the connections between balance of payments adjustment and the need for reserve creation in the form of SDR's.
>
> Today I propose to summarize for the Committee the main points involved in these two issues.
>
> While there was much discussion at the meeting about the impact of U. S. monetary conditions on other countries, support for present U. S. monetary policy was strong. No one questioned the need for it. If

anything, there was skepticism about the determination of American authorities to persist with sufficiently firm monetary and fiscal policies. This skepticism was expressed not only in Europe but also among Latin American central bank governors at Williamsburg in the past two days.

Thus, the WP-3 discussion was concerned not with the posture of U. S. monetary policy but with whether the United States should not do something to temper the effects of its tight money policy on the Euro-dollar market.

Among the countries represented at the WP-3 meetings only two or three were concerned about the effect on their own financial conditions. The Belgians are most vocal here--though their reasons are not very clear. The Dutch complained mildly that high Euro-dollar rates are resulting in less credit availability within the Netherlands than is planned by the authorities, but it was not explained why the Netherlands Bank cannot offset this shortfall unless it is worried about its reserves. The representatives of Sweden, Switzerland, Japan, Canada, and Germany either welcomed or are willing and able to live with present conditions in the Euro-dollar market. The French complained but stated that they were not being affected. Germany has not been experiencing an outflow of short-term funds--given the large forward premium on the mark--and welcomes the leeway to raise its own short-term rates.

Although several Europeans insisted that their reserves are adequate and they are not concerned about their reserves, their actual arguments belied their statements in this regard.

For example, the Belgian, Dutch, and German representatives stated that they are experiencing a shortage of intervention currency--that is, freely usable dollars. They had to be reminded by the Swedish and Swiss delegates that a shortage of dollars can be relieved by selling gold. If countries are reluctant to sell gold, it is difficult to maintain that they are not concerned over reductions in their reserves. One answer given here was that the reduction in reserves is temporary and countries are hesitant to sell gold to relieve a temporary shortage of dollars.

Again the Swiss delegate provided a helpful answer by pointing out that a number of countries did not hesitate to buy gold earlier when dollars flowed in.

On the basis of the general discussion, one can say that the case for action by the United States to temper the pressure of U. S. monetary conditions on the Euro-dollar market is as follows:

(1) To some extent interest rates in Europe may be driven up more than is desired by European monetary authorities. This would be unfortunate in its effects on economic conditions in Europe and it may be followed by too much delay, later, in getting European rates back down.

(2) The larger the inflow of Euro-dollars to the United States now, the greater the potential back-flow when monetary conditions change in the future. This would depress the value of the dollar on exchange markets and have unfortunate effects on confidence. In other words, the United States does not need such a large surplus now, especially in view of the unsatisfactory structure of its balance of payments.

For our part we pointed out that the Euro-dollar inflow is a by-product of U. S. policy and not a deliberate objective. The inflow does not undermine U. S. monetary policy. We also noted that even if the Euro-dollar market did not exist, European short-term money would no doubt be coming directly to the United States under present conditions.

Furthermore, if the Federal Reserve were to adopt measures to discourage U. S. banks from borrowing from their branches, there are other channels through which Euro-dollars can flow to the United States (as is pointed out in the paper the staff recently circulated to the Committee[1/]). Thus, though it may be possible to

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1/ The memorandum referred to, dated April 16, 1969, and entitled "Measures to Affect Use of Euro-dollars in the United States," was distributed to the Board of Governors and Reserve Bank Presidents on April 17. A copy has been placed in the Committee's files.

slow down the inflow, it is impractical to think of stopping it in a world in which most countries do not use exchange controls. We reminded the Working Party that in the earlier 1960's, when monetary conditions in Europe were tight, part of Europe's surplus reflected short-term capital inflows.

On this subject, the Working Party was left with the impression that the United States is sensitive to the effects of its policies on other countries and is willing to consider all practical measures, in a spirit of cooperation, to deal with such problems.

On the other major subject--the relationship between the adjustment process and reserve creation--I believe that further progress was made. The simple arithmetic is that if the United States is in official settlements balance--and therefore not creating reserves in the form of dollars--if the United Kingdom and France are in surplus--as will be necessary if they are to repay debt--and if the less developed countries continue to add to their reserves year by year--then the other developed countries and Europe in particular must be losing reserves unless new reserves are created. There is no escape from this arithmetic necessity. Yet if the other developed countries resist such losses of reserves, it will not be possible for the United Kingdom, France, and the United States to achieve their balance of payments objectives.

The argument was summed up very well by one delegate who said that if it is seen that the United States, France, and the United Kingdom have adopted the policies that are necessary to start the process of balance of payments adjustment, then there is a good case for early activation of SDR's as a means of facilitating the accommodating actions by other countries.

In reply to a question by Mr. Daane, Mr. Solomon said that Japan had accumulated about $1 billion of reserves during the past year and the Japanese expected their payments position to remain strong. Japan's reserve gains, of course, added to the pressures on the reserve positions of other countries.

Chairman Martin then called for the go-around of comments and views on economic conditions and monetary policy, beginning with Mr. Hayes, who commented as follows:

> Nearly all recent data confirm that the business situation and outlook remain decidedly inflationary. The earlier signs of weakening consumer demand and a resulting inventory problem have apparently faded away. Housing starts have been off somewhat, but the March decline may have been largely a reaction to the unusually high rate of starts during the winter. It may perhaps also have reflected a temporary interruption in the flow of mortgage money from thrift institutions awaiting a reading on their deposit performance in the past interest and dividend crediting period. The proposed repeal of the investment tax credit would probably reduce only to a modest extent the inflationary stimulus arising from plant and equipment spending. On the other hand, consumers and corporate spenders alike will be encouraged by the prospect of a lower tax surcharge after the end of 1969. Our GNP projections, even though they include a sizable further rise in the saving ration which may not be realized, suggest only a modest further slowing of real economic growth and only a very small dent in the rate of price inflation by the end of this calendar year.
>
> It is hard to avoid a feeling of disappointment over the absence to date of any appreciable effect of policy measures on the real economy. However, the importance of lags has doubtless been underrated, and I still believe the cumulative underlying effect of fiscal and monetary actions will become visible later in the year.
>
> On the balance of payments front the prospects appear equally gloomy. Since the beginning of 1969 the U. S. liquidity balance has been almost constantly in heavy deficit. Granted that much of the first quarter's very poor showing reflects the partial reversal of the huge year-end inflows of corporate funds--with the relative import and export effects of the dock strike termination also an adverse factor--it is hard to foresee anything but a large liquidity deficit for the full year.

Already there are signs of a slower pace in the inflow of foreign funds into our stock market. So far, of course, the official settlements balance has been in comfortable surplus because of the continuing heavy borrowings by U. S. banks from their branches abroad.

In good part because of this situation, the dollar remains in a reasonably strong position in the foreign exchange markets, as it has been for many months. At the same time we must recognize the current sensitivity of the exchange markets, reflecting major uncertainties with respect to the German mark, the French franc, and sterling. We cannot rule out a crisis which would once again involve the dollar. From a longer-run point of view it is a bit unnerving to contemplate the effects on our official settlements balance of any future turn to easier money in this country and a consequent heavy reversal of the inflow of funds from foreign branches.

As usual, the current banking and monetary statistics are somewhat difficult to interpret because of temporary "technical" and special developments. Thus, the strong rise in the bank credit proxy projected for April partly reflects a temporary buildup of Treasury deposits, and the proxy is expected to weaken again in May as these deposits are run off. At the same time, however, the conventional proxy measures understate the flow of credit through the banking system as banks reduce both their assets and liabilities by loan sales to foreign branches and to parent one-bank holding companies. While the degree of understatement does not appear to be serious yet, it could quickly become serious if additional major banks join the loan sales game. The very rapid spurt in the money supply now estimated for April is clearly unfortunate. Apparently only a part of this outsized increase is due to technical--and temporary--factors. Publication of the numbers will no doubt complicate the System's "credibility" problem.

It is hard to reach a judgment as to the degree to which banks and other financial markets, and the public generally, have yet accepted that policy is seriously restrictive and will continue to be so until there is a significant stabilization of the economy. While recent policy measures have helped to strengthen

convictions as to the System's intentions, there has at the same time been some feeling in the financial markets that interest rates have peaked; also, many banks seemingly continue to look upon the current tightness as a temporary situation that will not persist for long, and they are preoccupied with finding new techniques to avoid having to take too restrictive an attitude toward their customers.

Under all the circumstances I have outlined, I see no alternative to an open market policy of at least maintaining the degree of tightness that has developed in the money market since the last FOMC meeting. With the terms of a Treasury refunding expected to be announced tomorrow, even keel considerations preclude and major policy moves for the time being.

In suggesting that open market operations be aimed at maintaining the firmer tone that has recently developed, I have in mind a Federal funds rate range of roughly 7-1/4 to 7-3/4 per cent, borrowings in the range of $900 million to $1.2 billion, and net borrowed reserves of between $800 million and $1.0 billion. With special seasonal factors tending to depress the bill rate, we must expect a continuing, and perhaps even widening, gap between this rate and most market interest rates. Because of the continuing seriousness of the inflationary threat I would hope that the Manager would tend to operate toward the upper end of the target ranges I have mentioned.

I would accept the directive proposed by the staff as accommodating such a tendency. A proviso clause should be retained and should be implemented vigorously if the expected reversal of the April bulge in the credit proxy does not materialize. I would suggest a very modest revision in the opening lines of the draft directive to change the emphasis slightly. Specifically, I would insert the word "only" after "moderated," and place the statement about prices and costs in a new sentence beginning with the phrase "at the same time." The opening sentences would then read, "The information reviewed at this meeting suggests that expansion in real economic activity has moderated only slightly since the fourth quarter of 1968. At the same time, substantial upward pressures on prices and costs are persisting."

Mr. Morris said it was his conviction that the Committee was on the right track with respect to policy and that if it adhered to its present course it should expect to see some meaningful results in the real economy before the third quarter was over. That judgment did not suggest that he was afflicted with "statisticitis" since he had not as yet been able to find any significant support for it in the economic statistics. The decline in March in the composite index of leading series, which received so much notice in the press this morning, unfortunately was not large enough to have much statistical significance in itself; and certainly the improved tone in the bond market was a fragile thing. Nonetheless, those were the sorts of things which should be happening now if there was going to be an inflexion point in the economy five or six months hence.

Mr. Morris said he had invited the presidents and the chairmen of the leading Boston banks to lunch yesterday in order to get a feel for their thinking. In general, they were convinced that the System's current policy would be successful, although they had cautioned against expecting to see immediate results. None of them, however, advocated a more restrictive policy designed to get results at a faster pace.

Mr. Morris went on to say that when he had asked the bankers what the System might do that it was not now doing, he received one idea from Roger Damon, Chairman of the First National Bank of Boston, which he thought had enough merit to bring to the Committee's attention. Mr. Damon suggested that some sort of voluntary restraint program should be initiated relating to bank loans for the purpose of facilitating mergers and acquisitions. He argued that the acquiring firms typically had enough financial leverage to make it difficult for the individual bank to turn them down without some sort of official crutch to lean on. He felt that that sort of financing was particularly unfortunate because much of the resulting new money flowed into the stock market. He also felt, and Mr. Morris agreed, that a significant break in stock prices was probably a necessary condition for a break in inflation psychology. It was for that reason that Mr. Morris believed Mr. Damon's idea was worth exploring by the Board of Governors.

In general, Mr. Morris thought the degree of financial restraint now in force was appropriate and he supported the staff's draft directive. However, he shared the concern that Messrs. Hayes and Mitchell had expressed about the ballooning of the monetary aggregates in April, and he endorsed Mr. Hayes' suggestion that the proviso clause be implemented vigorously if the expected reversal did not develop.

Mr. Coldwell reported that economic activity in the Eleventh District showed increased momentum in March. Industrial production was up 1 per cent, employment rose seasonally, and unemployment was at the irreducible minimum in the District's large cities. There was some slowing in retail sales, but auto registrations were rising. Agricultural conditions reflected rainfall delays, and winter wheat production was estimated to be down 6 per cent from 1968.

With respect to District financial conditions, Mr. Coldwell remarked, there still was evidence of restraint, but also of continued loan accommodation. A recent survey of large savings and loan associations in the District reflected divergent patterns of savings flows and commitments. Most, however, expected the change in savings flows to be similar to or below that of last year and future commitments to be below those of 1968. Rates charged had increased in recent weeks to 8 per cent.

Nationally, Mr. Coldwell observed, economic conditions still reflected growth and upward wage and price changes remained large. Despite some bank restraint the demands for credit were heavy and many were still being met. Consumer and business psychology appeared to have been shaken only slightly and decisions were being made on the basis of inflationary expectations.

As to policy, Mr. Coldwell continued, he recognized that the Treasury would be engaged in a refunding. Within the context of the refunding he would recommend maintaining at least the degree of restraint that had been achieved and resolving any doubts on the side of restraint. Recently he had also suggested that the System make a direct appeal to banks for restraint on loans and he continued to advocate that step partly for the reason Mr. Morris had just offered--banks were unable to exercise the necessary restraint themselves without some official support.

Turning to the directive, Mr. Coldwell said he would favor Mr. Hayes' suggestion with respect to the opening sentence. In addition, he would delete the statement regarding first-quarter changes in bank credit and the money supply, which at this point was of only historical interest, and expand the statement regarding the large increases in April. For the latter purpose, he would propose a sentence reading, "In early April both bank credit and the money supply increased substantially, largely as a result of the change in Treasury balances, sharp tax-date borrowing, and seasonal deposit shifts around Easter."

Mr. Swan remarked that the pace of business activity in the Twelfth District picked up in March, both absolutely and relative to the nation as a whole. The pick-up, which was

reflected in such measures as employment, unemployment, housing starts, and bank loans, appeared to be broadly based. The unemployment rate had dropped from 4.5 per cent in February to 4.3 per cent in March despite a continuing decline in employment in the aerospace industries. Business loans at banks had begun to rise more rapidly in mid-March and were very strong in subsequent weeks. While major District banks had remained net sellers of inter-bank Federal funds, the margin of their net sales had narrowed considerably and they expected to be net buyers in the current week. On the other hand, borrowings from the Reserve Bank, while fairly well maintained in dollar terms, had been under 10 per cent of the national total in each of the six weeks since March 12, reversing the pattern of the preceding weeks. In short, an assessment of conditions in the Twelfth District simply reinforced what had been said about the national picture.

As to policy, Mr. Swan agreed the Committee would have to maintain an even keel in view of the Treasury financing. However, in light of the April developments in bank credit and money, he certainly agreed that the Committee could not afford to relax the present degree of restraint. He also shared the view that firmer conditions should be sought, to the extent feasible, if the April developments were not reversed. Accordingly, he

saw very little reason for a two-way proviso clause in the directive, and would recommend a one-way proviso instead. He favored the change Mr. Hayes had suggested in the first paragraph. Also, he would either adopt Mr. Coldwell's suggestion for the statement regarding bank credit and money or simply delete the reference to "temporary factors." One or the other of those changes seemed desirable because, as had been indicated earlier, the language of the sentence in the draft was equivocal.

Mr. Galusha commented that the story of the Ninth District economy in April was very much the same as that of the national economy, so he could pass on almost immediately to Committee policy. He did want to note, however, that mortgage commitments of District savings and loan associations had decreased in March, despite an essentially unchanged inflow of funds. That was the first decrease in commitments in some time, but it was far from clear that a new trend had started. Construction employment, seasonally adjusted, also decreased in March, but he was inclined to regard that change as a statistical aberration. A good deal had been heard of late about a changing seasonal pattern in District construction.

With the Treasury about to announce its refunding terms, Mr. Galusha said, a policy of even keel would seem appropriate. He accepted the monetary targets given in the blue book. With

respect to the directive, both the language change proposed by Mr. Hayes and the deletion of the phrase regarding temporary factors suggested by Mr. Swan seem to him to be improvements. The latter change struck him as particularly desirable since the precise nature of the "temporary factors" referred to was not clear at the moment.

Mr. Scanlon reported that the general economic picture in the Seventh District continued to reflect rising activity and expectations of further increases in demand and prices. Midwest business economists appeared generally to concur with that evaluation of the current situation. They also appeared to be in agreement that slower growth in spending would be evident in the second half, especially if money and credit expansion continued moderate and the Federal budget continued to move toward surplus.

A few local developments tended to support the view that a slowing in aggregate spending would be evident some months hence, Mr. Scanlon said. There were scattered reports of business expenditures being postponed because of an inability to obtain credit on satisfactory terms, especially construction loans. Farm machinery sales had continued below year-ago levels in the recent months of seasonally small volume, and there had been some reports of reduced recruiting of hard-core unemployed for training programs.

Nevertheless, Mr. Scanlon continued, there was little slack in the economy of the Seventh District. Order lead-times were lengthening further. Employers reported intentions to hire more workers in the near future and, incidentally, the Reserve Bank's Personnel Department reported a record number of unfilled requisitions on hand. Most firms were attempting to increase inventories. Steel mills in the Chicago area were working at practical capacity, with output near the record level reached in March last year. Orders from a wide variety of steel users had offset the seasonal decline in demand for steel for passenger cars. In the Detroit area, production had declined since mid-March.

In the first half of April, Mr. Scanlon observed, loans to businesses at weekly reporting banks in the District rose more than last year but somewhat less rapidly than for the country as a whole. A number of those banks, especially in Chicago and Milwaukee, continued to show very low liquidity positions. Euro-dollar liabilities had risen, net Federal funds acquired remained near record highs, and liquidation of both Treasury and municipal securities had continued during the past month. Loan-deposit ratios of the largest Chicago banks, exclusive of Federal funds sales and adjusted for cash items, now averaged over 80 per cent, with one bank over 100 per cent--

well above the peaks reached in 1966. Those banks had not been borrowing much at the discount window.

At smaller member banks, Mr. Scanlon continued, loans had risen very rapidly since the end of February, while liquidation of Governments had been less than acquisitions of other securities. Loan demand appeared very strong at those banks and they still had relatively low loan ratios. There was some sale of loans to the smaller banks by the money market banks but he had no measure of how much. Some of the District's banks were using large amounts of Euro-dollars. One bank had liabilities to foreign branches equal to 21 per cent of its "deposit" liabilities and to about 10 per cent of the total of liabilities to foreign branches for all U. S. banks. That fact was of some concern to him.

Although past monetary and fiscal policies appeared to have contributed to some slowing in the economy, Mr. Scanlon said, the rate of economic advance was still resulting in an intolerable rate of inflation. He was somewhat disturbed, therefore, by the relatively large increase in bank credit and the money supply now estimated for April. He had been reasonably satisfied with the rate of monetary and credit expansion achieved in the first quarter of the year and would like to hold fairly close to those rates. In view of the increases in April, the

current projections of money supply and bank credit for May appeared acceptable as goals of policy. The draft directive, with the amendments suggested by Messrs. Coldwell and Hayes, was acceptable to him.

Mr. Clay observed that the fiscal measures recently announced by the Administration, if carried out, should prove constructive in the effort to provide a more balanced pattern of economic activity. At the same time, it was essential that the firmness of monetary policy be continued. Evidence of moderation in economic activity thus far was relatively limited and was not sufficient to give assurance of policy success. Moreover, cost-price pressures continued virtually unabated. While there had been substantial financial response to credit restraint, no relaxation would be appropriate in view of the developments in the real economy.

Mr. Clay thought that monetary policy targets for the period ahead might include a Federal funds rate of 7-1/4 to 7-3/4 per cent, member bank borrowing of $800 million to $1.2 billion, net borrowed reserves of $800 million to $1.1 billion, and a Treasury bill rate of 6.0 to 6.20 per cent.

The April growth in bank credit was considerably larger than anticipated, Mr. Clay said. Now a Treasury financing operation was approaching, and that entailed the usual risk of

creating bank credit beyond expectations. There was a substantial difference between the Board and the New York Reserve Bank staff projections of the member bank credit proxy for May, assuming continuation of prevailing money market conditions.

Mr. Clay noted that while the blue book suggested the likelihood of higher intermediate- and long-term interest rates over the next few weeks, it mentioned the possibility of strong expansionary effects on monetary aggregates should market anticipations of higher bond prices develop because of evidence of weakening economic activity or progress toward peace. No concern need arise over a very modest growth in bank credit of perhaps 2 or 3 per cent. Strenuous restraint efforts would be called for if a faster rate of growth appeared in the making.

The draft policy directive appeared to Mr. Clay to be satisfactory.

Mr. Heflin observed that the business advance in the Fifth District appeared to have abated little, if any, in recent weeks, although the Richmond Reserve Bank's latest survey suggested a few more signs of developing moderation than had been present earlier in the year. The District textile industry remained in the doldrums and the latest information indicated that residential building outlays might have topped out.

Moreover, business respondents in the Bank's survey expressed somewhat less exuberance about the future than they had in February and March. Nevertheless, retail trade and nonresidential construction continued strong and, on balance, most of the Bank's latest information remained generally bullish.

At the national level, it seemed to Mr. Heflin that the preliminary Commerce Department data for the first quarter reflected no slowdown at all from the fourth-quarter pace. The small indicated reduction in GNP growth was less impressive than the large increase in final sales and the sharp step-up in the pace of consumer spending--which, incidentally, came in the face of a considerably less congenial tax situation. The figures on final sales and inventories suggested to him that businessmen might not have reached their inventory targets last quarter and, given the current price environment, he would not be surprised to see another surge of stockbuilding in the weeks ahead. Moreover, while the first-quarter increase in business fixed investment was unusually large, he was not confident that subsequent quarterly gains would be cut back as sharply as the green book projections indicated. The strong rally in the bond market over the past three weeks suggested that, despite the System's tight posture, there was still an abundance of funds in the market to finance business spending

plans. Repeal of the investment tax credit could help, but with inflationary expectations continuing strong he believed it would be a mistake to expect any significant restraining effect from that quarter over the next six months.

It now seemed reasonably certain that residential construction outlays would decline in the near future and that more fiscal restraint was in prospect, Mr. Heflin remarked. Moreover, the recent slowdown in the automobile industry appeared to be continuing, if not deepening. Nonetheless, viewing the over-all picture, he thought it would be premature to conclude that there was substantive evidence of any significant moderation in the business advance.

Although he realized that the Desk had faced a difficult job in the latest period, Mr. Heflin said, it seemed to him that the indicated rates of growth in the credit proxy and money supply in April were not consistent with the policy posture the Committee had tried to project. Recent developments in the bill and bond markets indicated to him that, despite the System's tough posture over the past four months, a substantial residue of liquidity remained in the economy. Under the circumstances, he thought it was imperative that bank credit and money growth be kept under close control and he was inclined to view as excessive any annual growth rate much above 2 or 3 per cent.

Over the coming period, Mr. Heflin continued, the Committee faced a dangerous, if not critical, situation in the international exchanges as well as an even keel constraint. On both counts, it could afford little in the way of an overt tightening move. Yet he thought pressure should be kept on the banking system and on the market, about in line with conditions obtaining last week rather than in the two weeks immediately preceding. Federal funds rates, it seemed to him, should average 7 per cent or higher, with both borrowings and net borrowed reserves in the neighborhood of $1 billion. He also thought that bill rates should not be allowed to move much below current levels. He favored making the change in the draft directive that had been suggested by Mr. Hayes. And, if he correctly understood the comments of Messrs. Sternlight and Partee regarding the April bulge in bank credit and money, he thought that in the phrase "partly as a result of temporary factors," the word "partly" might be changed to "largely."

Mr. Mitchell said he thought System policy was on the right track. It was unfortunate that recent policy had not yet produced more in the way of results, but results should not have been expected this soon.

Turning to the directive, Mr. Mitchell remarked that the question of how the early April bulges in bank credit and money

were described was important. In light of Mr. Partee's comments he would suggest language reading ". . . but in early April both measures increased substantially, apparently as a result of self-reversing factors." It would be desirable to include the word "apparently" because at this juncture one could not be certain about the indicated self-reversal. With respect to the second paragraph, he concurred in Mr. Swan's view that a one-way proviso clause was desirable, and would suggest language reading ". . . provided, however, that operations should be modified, to the extent permitted by the Treasury financing, if bank credit growth does not moderate substantially from the estimated April rate." In his judgment a one-way proviso was needed because there was a real risk that bank credit and the money supply would prove to be stronger than projected in May, for the reasons noted in the blue book passage to which Mr. Clay had referred. He thought the Desk would have to take aggressive action if bank credit growth did not moderate substantially in May.

Mr. Daane said he agreed in general that monetary policy was on the right course, but he had some doubts as to whether that course was being pursued vigorously enough. Were it not for even keel considerations, he would suggest that the System

act a bit more aggressively in applying restraint, and hold back even more than it had on the supply of reserves relative to demand. The Treasury financing limited what could be accomplished at this juncture, but within the even keel constraint he would hope that any errors would be on the side of restraint and that the Desk would take advantage of every opportunity to move in that direction. He would not be disturbed if the money market variables went beyond the tight end of the ranges given in the blue book; he had always considered blue book specifications as general guideposts rather than rigid targets. He would accept the change Mr. Hayes had suggested for the first paragraph of the directive, and he shared the sense of uncertainty some members had expressed with respect to the implications of the April developments in the monetary aggregates.

Mr. Maisel said he would support the draft directive in the form submitted by the staff.

Mr. Brimmer remarked that he agreed with the policy course indicated by the staff's draft directive, and favored retention of the two-way proviso shown in the draft. He thought the changes Mr. Hayes had suggested in the first paragraph were desirable.

Mr. Brimmer then said that Mr. Robertson's comment on the need for revision of the statement in the draft regarding the early-April bulges in bank credit and money had prompted him to attempt a reformulation. He gathered from some notes Mr. Axilrod had prepared at his (Mr. Brimmer's) request that the bulge in private demand deposits was associated in large part with technical accounting considerations related to the effect of the long-Easter weekend on the roll-over of Euro-dollar borrowings by U. S. banks. And, as had been noted in the discussion today, domestic tax-date borrowing also was an important factor. Hopefully, those developments would be reversed, but that was not certain. If the statement were to be revised, it might be best to pin-point the reasons for the early-April developments in a separate sentence concerning them. He would suggest dividing the statement into two sentences, as follows: "In the first quarter of the year bank credit changed little on average and the money supply grew at a sharply reduced rate. In early April both measures increased substantially, influenced in part by large tax-date borrowing and deposit bulges around Easter."

Mr. Hickman said it was difficult to find any substantial evidence of easing in terms of current spending flows in the economy. The decline in durable goods orders

in March--which was confined chiefly to the aerospace industry--and some slowing in labor force and employment growth last month might be only straws in the wind. Although real growth in both retail sales and disposable personal income had declined sharply, higher taxes had had a large impact in the first quarter. Moreover, even though economic activity might be slowing in real terms, the preponderance of recent business and financial news did not suggest much relaxation in inflationary pressures. It would take still more time before slackened growth in the real sector would be translated into a diminished rate of inflation.

Given the decline in the bank credit proxy in the first quarter, Mr. Hickman believed that the growth in April was not inappropriate--although it clearly exceeded the Committee's intent, and if sustained over a longer period would be inconsistent with his prescription of moderate growth for bank credit. Modest growth in bank credit in the second quarter would be necessary to provide a sustainable base for the economy, especially if the rate of expansion in the real sector actually was slowing. However, the Committee should make sure that the gains in the credit proxy remained moderate and did not accelerate, just as it should have been concerned about the too rapid

gains in the last half of 1968 and the too rapid decline in the first quarter of 1969 as a whole.

Mr. Hickman commented that those sharp swings in policy should be avoided if at all possible. In particular, the Committee should not attempt to cancel out in May the 7 per cent growth in bank credit now expected for April, but rather should seek a small sustainable rate of growth. The thrust of the President's fiscal program, coupled with gradual growth in the reserve and credit aggregates, should be sufficient to turn the tide in inflationary expectations. It was neither necessary nor desirable to precipitate a monetary crisis in order to achieve that objective. With that in mind, as well as the Treasury financing that would be announced shortly, he supported the staff's draft directive, calling for even keel.

Mr. Bopp remarked that his problem in formulating a policy position today was in striking a balance between near-term and longer-term considerations. For the near term, solid evidence of strength in the economy was prevalent. Thus, the preliminary figures for gross national product in the first quarter and the March increase in consumer prices and in industrial commodities prices at wholesale were disappointing to those who had looked for greater moderation by now. In light of the strong first quarter, further advances in industrial

production, retail sales, and personal income were likely. Despite the drag from tax reconciliation payments, there now seemed to be little question of considerable strength in the economy during the current quarter. The staff at the Philadelphia Reserve Bank was projecting a gain in GNP of more than $14 billion, with final sales growing only a little less than in the first quarter.

Mr. Bopp noted that the Reserve Bank's April business outlook survey indicated that the region's economic posture was still one of strength, with a majority of respondents expecting higher levels of business activity six months from now. However, the survey also indicated that the number planning to hire additional employees or to extend the workweek during the next half-year had declined since the first quarter of this year. Apparently some of the District's regional manufacturers saw an easing in the rate of business expansion ahead.

So much for the near-term outlook, which he read as over-all strength, Mr. Bopp said. The troublesome policy considerations were the longer-term ones. First, since the beginning of the year, bank credit had contracted and the forecast was for more of the same in May. Bank reserves also had declined. Secondly, the President's proposed program for additional fiscal restraint, if enacted, would add a fiscal

bite to the monetary bite. Of course, the fate of the fiscal proposals was uncertain. But even if they were not implemented, the bite of monetary policy during the past four months was bound to be felt later on. If, in addition, fiscal restraint did materialize, the combination of the two might prove too much.

Complicating monetary management, Mr. Bopp continued, was the Committee's ignorance about the ability of financial institutions to adjust to restraint. At the last meeting of the Philadelphia Reserve Bank's Board, one director had commented on the growing concern of several large insurance companies about policy loans. A check with several large companies in the Third District revealed that their policy loans were considerably higher than at the 1966 peak. So far in 1969, they were running at substantially higher rates than in 1968, as the green book indicated was also the case nationally.

Mr. Bopp continued to be impressed, however, by the resiliency of financial institutions and by their ingenuity in finding escape valves. That resiliency was corroborated by the findings of last week's conference call of discount officers. Nevertheless, while the adjustment thus far had proceeded without major disruption, the performance of the money and credit aggregates had been such that the threat of a crunch could not be wholly discounted. That was an additional reason--although

he believed secondary to the longer-term considerations--for not adding further restraint to that which had been cumulating since the beginning of the year.

Mr. Bopp noted that even keel would be operative for most of the period between now and the next meeting. He favored the directive with the modifications suggested by Messrs. Hayes and Mitchell.

In a concluding comment Mr. Bopp said he was not sanguine about voluntary credit restraint programs. They presupposed greater wisdom than the System might have as to what was "productive" credit. He was reminded of the history of the real bills doctrine. Not every take-over was "unproductive" in real terms. Not every borrowing to purchase goods and services, especially those in short supply, was productive in real terms or noninflationary. Selective credit controls might appear a tempting road to some; to him they were a slithery path to be avoided if possible.

Mr. Kimbrel reported that voluntary credit restraint by major banks had been the subject of considerable corridor comment at the recent spring council meeting of the American Bankers Association at White Sulphur Springs. The bankers hoped that the Federal Reserve System would provide a crutch for declining to make loans. He was not unmindful of the fact

that such an approach might be good in theory and could produce prompt results. For his part, however, before advancing such a suggestion for consideration by the Board of Governors, he had asked his staff to refresh his memory about the shortcomings experienced in the last effort at voluntary credit restraint. Pending the results of that staff work, he associated himself with the views expressed by Mr. Bopp.

Mr. Kimbrel then noted that member banks in the Sixth District apparently had come under some increasing pressure in March and the first half of April. However, the pressure had been relatively mild and fairly well confined to a few of the larger banks. Although member bank borrowing increased somewhat, the amount during the week ended April 23 averaged only $48 million and was confined to a relatively few banks. On the other hand, purchases of Federal funds averaged in the $500-$575 million range during March and the first half of April.

That the pressure had not been great, however, was suggested by the excess of sales of Federal funds over purchases for the District as a whole, Mr. Kimbrel continued. Most of the funds were coming from the country banks, with Florida accounting for three-fifths of the total. Deposit growth continued in March in contrast to the national pattern. Early April showed

further expansion. Loan growth continued strong, with liquidation of investments confined fairly well to the large banks.

Mr. Kimbrel remarked that on April 1 the District's Tennessee member banks had been freed from certain interest rate restrictions that had handicapped them in competing for time deposits. Not only had Tennessee banks been limited as to what interest rates they could charge; they also had been limited as to what they could pay. Thus, they had not been able to compete effectively for large-denomination CD's nor to offer competitive rates for consumer-type CD's. The banks had responded to the new legislation permitting them to pay rates equivalent to those set forth in Regulation Q by immediately offering consumer-type CD's and bidding for large-denomination CD's. One result was an increase in outstanding CD's at large Sixth District banks as a group for the first time in several months.

Mr. Kimbrel said he wished he could report that there was more evidence in the nonfinancial news from the Sixth District that major pressures were being placed upon the expansion. That simply was not the case. Nonfarm employment might have slowed down a little in March, according to incomplete data, but construction activity remained strong, as did most measures of income and spending.

There was little he could add to what was being said today about the national economic scene, Mr. Kimbrel observed. He had been cheered by the good news that the wholesale prices of industrial commodities rose only one-tenth of 1 per cent from March to April. Even though lumber and plywood prices were almost entirely responsible for the slowdown, any slowdown was welcome.

Under those conditions, there seemed to Mr. Kimbrel to be no alternative to keeping as tight a rein as possible under the circumstances. He hoped that the Committee would not, either intentionally or unintentionally, lighten the pressure. With the Treasury refunding and even keel considerations, that might be hard to do. During the period when the System was free, he would like to see a focus on keeping money market rates in the upper range of those specified in the blue book and invoking the proviso clause promptly in the event that bank credit appeared to be stronger than projected.

Mr. Kimbrel said he would be willing to leave construction of the directive in the hands of others, hoping again that any errors in implementing it would be on the side of restraint.

Mr. Francis commented that total demand for goods and services had remained excessive with resultant upward pressure on prices. There were few encouraging figures in that respect.

The recent data, including the jump of prices in March, should simply reinforce the System's determination to follow a course of monetary action that would slow inflation.

There was considerable evidence from past experience that monetary actions influenced economic activity with a lag, Mr. Francis observed. Consequently, the Committee should not become disturbed that total spending and inflation had not yet slowed much in response to the tighter monetary stance of the first quarter. Much of the effect of the first-quarter actions would be felt later if reacceleration could be avoided, as possibly presaged by April developments and any forthcoming even keel. Today, the Committee needed to determine what monetary actions in the immediate future would be conducive to desirable growth of total spending and real product two quarters or so from now.

Mr. Francis thought the System's actions in the first quarter, as measured by the rate of expansion in the money supply, bank reserves, and the monetary base, had been appropriate. The money supply, after growing at about 7 per cent annual rate from January 1967 to July 1968, increased at about a 5 per cent rate from July to December and at a 2.3 per cent rate in the first three months of this year. Slowing in the demand deposit component was somewhat greater. That was a policy of

gradualism in view of the so-far unrelenting inflation problem with which the System had to deal and in view of a trend growth of money of about 2-1/2 per cent per year.

As to the future course of action, it seemed to Mr. Francis that if the Committee desired to have reasonable assurance that the rate of growth of total spending during the last half of the year would be held to about a 5 or 6 per cent rate, as compared to the excessive 7-1/2 per cent rate of the past two quarters, it should undertake to hold the growth of monetary aggregates to relatively low rates for the next six months.

Mr. Francis thought it was desirable that the Committee consider a time horizon of as much as three months since it was not practical, and probably not desirable, to ask the Desk to achieve targets in terms of so short a period as three or four weeks. Of course, as the Committee met each three or four weeks it should reconsider the target each time and restate it in terms of three months or longer.

Mr. Francis said studies at the St. Louis Reserve Bank indicated that, if the money stock were to be unchanged from the first to the second quarter and thereafter increased at a 2.5 per cent annual rate, total spending would most likely slow from the recent 7-1/2 per cent rate to about a 6 to 6-1/2 per cent

rate in the second quarter and further to a 5 to 5-1/2 per cent rate or less in the last half. He suggested that the System control Federal Reserve credit, the monetary base, and member bank reserves so as to cause the money stock to follow such a course.

Limiting the growth rate of money to zero from the first to the second quarter and then to 2-1/2 per cent would be only a moderately tight policy judged in terms of experience, Mr. Francis continued. For nine months in 1966 the stock of money had been on a virtual plateau. From that action the Committee had achieved a needed, although unfortunately unsustained, deceleration in spending. In the twelve years from 1953 to 1964 money grew at an average 1.8 per cent rate.

If the System should follow a policy of no growth in the monetary aggregates for a limited time, followed by moderate expansion, Mr. Francis thought it should not be concerned if initially there was not much abatement of the inflation in the early stages of deceleration of total spending. Also, if the demand for loan funds declined with the slowing in total spending as it usually did, the System should not interfere with the resultant decline of interest rates.

In conclusion, Mr. Francis said, it seemed to him that policy in the first quarter was appropriate. However, he was

concerned over the marked rise in money during April. Some of the rise was probably a temporary fluctuation in the data, but he was disturbed, though not surprised, to note that other System actions more than offset the effect of the increase in reserve requirements. Also, it now appeared that, with the recent rise in Government demand deposits, and if the Committee encumbered itself with even keel considerations, there was a strong possibility that monetary aggregates would rise again in May. Adding to his concerns were statements in the blue book that "The System is expected to supply a substantial volume of reserves over the next three weeks," and ". . . it is quite possible that a strong demand pull would be exerted on monetary aggregates. In this event, bank credit and money supply in May could turn out to be stronger than projected. . ."

As for policy, Mr. Francis suggested a firm resolve to stop now the rapid monetary expansion of April. Money should be kept on a plateau near $195 billion for the next three months with a view to attaining a growth of total spending at about a 5-1/2 per cent rate in the last half of 1969. In order to prevent money from rising, the monetary base should be kept at about $77 billion. He felt that this was one period when it was so important that monetary restraint be imposed that even keel considerations should be secondary.

Mr. Francis said he strongly endorsed Mr. Bopp's comments with reference to additional voluntary credit restraint programs.

Mr. Robertson said he would summarize the remarks he had prepared and ask that the full text be included in the record. He then summarized the following statement:

> Given the fact that we are once again in an even keel period, a vote to keep monetary policy basically unchanged is in order. But, in view of the inflationary climate that still surrounds us, I think we should want the Manager to keep conditions as tight as he could within that even keel range.
>
> The sharp wholesale and retail price increases, continued strong expansion of private demand, and persisting inflationary expectations all argue for capturing and holding every bit of financial restraint we have been able to achieve. The additional tightening actions taken on both the monetary and fiscal side since our last meeting may have given public policy a little more grip on the situation, but business momentum seems too strong to be brought under control easily or quickly.
>
> Accordingly, I would like to see the Manager hold member bank borrowings around the billion-plus level recently reached, and keep the funds rate well above 7 per cent. Furthermore, I would favor his running these measures even tighter if needed to counterbalance any tendency for the three-month bill to fall significantly below 6 per cent, for the latter rate movement might begin to permit significant bank CD sales once again--and that, in combination with the bond market rally we have already seen, could foster a renewed sense of credit accomodation that would be distinctly counter-productive. I am prepared to hold the line from now until our next meeting, but I want it to be a tough line that we are holding.
>
> With these views in mind, I would be willing to to vote for the draft directive as suggested by the staff.

Mr. Robertson added that the change in the draft directive proposed by Mr. Hayes and some of the other suggested changes--including the shift to a one-way proviso in the second paragraph--were acceptable to him.

Chairman Martin said he agreed that an even keel posture was called for in the period immediately ahead. He favored maintaining about the recent degree of pressure. Although one could not be sure, he was inclined to think the System's policy was on the right course, and that patience was required at this juncture.

The Chairman then noted that while he had been prepared to accept the directive as drafted by the staff, he thought the change suggested by Mr. Hayes was an improvement. He also agreed that there was a problem with respect to the phrase in the draft reading "partly as a result of temporary factors." If the Committee wanted to include a more detailed statement about the April developments, he thought the modification suggested by Mr. Brimmer would be appropriate. Alternatively, the Committee might want to adopt the language Mr. Mitchell had suggested. He personally would have some question about the formulation Mr. Coldwell had proposed.

Mr. Brimmer observed that he was prepared to accept the directive in the form submitted by the staff, and had made his

suggestion for revision simply because the question had been raised. In any case, he would not favor the language Mr. Mitchell had proposed.

Mr. Mitchell remarked that either his own suggested language or Mr. Brimmer's would be acceptable to him.

Chairman Martin asked whether there would be any objection to accepting the changes proposed by Messrs. Hayes and Brimmer, and none was heard.

The Chairman then noted that the remaining open question with respect to the directive was the choice between the two-way proviso clause shown in the draft and the one-way clause Mr. Mitchell had proposed.

Mr. Hayes expressed the view that a two-way clause would be preferable. As he understood it, those who favored a one-way clause were concerned about the April bulge and were seeking to tighten the instruction for firming should a reversal not develop. In his judgment, however, that objective would be better served by retention of the two-way clause. For example, if bank credit appeared to be growing at a 2 or 3 per cent annual rate in May, a two-way clause such as was contained in the staff draft presumably would be implemented--subject to the constraint of the Treasury financing--since such growth would represent a significant deviation from the projection for a decline in May

at an annual rate of 2 to 5 per cent. On the other hand, growth at a 2 or 3 per cent rate could be interpreted as a moderation from the April rate, and thus would not necessarily call for implementation of a clause of the type suggested by Mr. Mitchell.

Mr. Mitchell observed that a two-way clause was acceptable to him.

Mr. Robertson commented that he also would find a two-way clause acceptable, so long as the Manager understood the Committee's intent.

Mr. Hayes then said that he would add his support to Mr. Bopp's comments regarding a voluntary credit restraint program. New York banks had been interested in having the Federal Reserve provide them with a crutch for some time, but he would be reluctant to see the System follow such a course, essentially for the reasons Mr. Bopp had mentioned.

Chairman Martin then suggested that the Committee vote on a directive consisting of the staff's draft with the changes that Messrs. Hayes and Brimmer had proposed.

> 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 information reviewed at this meeting suggests that expansion in real economic activity has moderated only slightly since the fourth quarter of 1968. At the same time, substantial upward pressures on prices and costs are persisting. Long-term interest rates have generally declined in recent weeks, but most short-term rates have risen somewhat. In the first quarter of the year bank credit changed little on average and the money supply grew at a sharply reduced rate. In early April both measures increased substantially, influenced in part by large tax-date borrowing and deposit bulges around Easter. The outstanding volume of large-denomination CD's has continued to decline and there was a net outflow of consumer-type time and savings deposits from banks and other thrift institutions in the first half of April. A sizable deficit reemerged in the U. S. balance of payments on the liquidity basis in the first quarter but the balance on the official settlements basis remained in surplus as a result of large inflows of Euro-dollars. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the reduction of inflationary pressures, with a view to encouraging a more sustainable rate of economic growth and attaining reasonable equilibrium in the country's balance of payments.

To implement this policy, while taking account of the forthcoming Treasury refunding, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the prevailing firm conditions in money and short-term credit markets; provided, however, that operations shall be modified, to the extent permitted by the Treasury refunding, if bank credit appears to be deviating significantly from current projections.

Chairman Martin then noted that the final report of the Joint Treasury-Federal Reserve Study of the U. S. Government Securities Market had been distributed to the Committee on

March 21, 1969.[1] A memorandum from Mr. Maisel entitled "Recommendation on Report of Treasury-Federal Reserve Study of the U. S. Government Securities Market"[2] had also been distributed. In his memorandum Mr. Maisel had suggested that before the report was published some changes were needed in general, but particularly in connection with the discussion of possible outright System operations in Federal agency securities. Mr. Maisel had also suggested that the recommendation in the report concerning agencies not be adopted but that instead a new committee be established to make recommendations as to whether or not broad public policy objectives would be enhanced by outright operations in Federal agency issues.

Chairman Martin observed that the Steering Committee had been working on the report for a long time and his own inclination was to publish it as soon as practicable. While he was not opposed to a further study by a new committee, he noted that a good deal of information had already been assembled on the subject of the Federal agency market. Accordingly, if the Open Market Committee so desired, the next step might be to consider whether experimental operations in agency issues should be

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1/ A copy of this report has been placed in the files of the Committee.

2/ A copy of this memorandum, distributed on April 8, 1969, has been placed in the files of the Committee.

authorized for the purpose of gaining the kind of experience that would be useful in making a judgment on the longer-run desirability of such operations. However, there had not yet been an opportunity to discuss the subject with the new Administration. For that reason he would suggest that the Committee defer consideration of the question until its meeting scheduled for May 27, in the expectation that that would provide an opportunity for Mr. Robertson and himself to explore the matter with the new Treasury officials.

Mr. Maisel said he had no objection to a postponement of the Committee's discussion. He added that it had been his intention that the new study committee he had recommended would make its report within a month or two. He believed that the Steering Committee's report needed editing to make clear that it dealt only with questions of the technical functioning of the market. He felt that the publication of the report in its present form could do serious harm to the Federal Reserve, particularly since some critics might conclude that the System was tending to give undue weight to problems of technical market functioning in its decisions on what were far broader public policy questions.

Mr. Daane agreed that the discussion of possible outright operations by the System in Federal agency issues should be postponed until the matter could be discussed with the new Treasury

officials. However, he demurred from the view that the Steering Committee, of which he was a member, had not considered the public policy aspects of the subject. It had done so in terms of both specific System objectives and the general public interest.

Mr. Hayes, who was also a member of the Steering Committee, expressed views similar to those of Mr. Daane.

At Chairman Martin's invitation, Mr. Axilrod outlined a number of possible changes in the Steering Committee's report which he thought might go some distance in accommodating Mr. Maisel's objections to the manner in which the subject of agency issues was treated. For example, he noted, the statement concerning the more general considerations relating to System operations in Federal agency securities, for which no detailed analysis was given in the body of the report, might be eliminated. Also, certain language changes could be made in the statement of conclusions regarding operations in agencies that would be consistent with the specific focus of that part of the report.

Mr. Mitchell indicated that while he had no objection to such editorial changes, he did have reservations about the propriety of editing the report of the Steering Committee, particularly since several members of that Committee were no longer associated with the Treasury or the Federal Reserve.

Mr. Daane commented that he would want to look very carefully at any proposed changes, since the report had already been approved by the Steering Committee.

Mr. Robertson said he thought the report was useful, and he had no objections to changes of the type Mr. Axilrod had outlined. However, in his judgment what was now needed was action to authorize experimental System transactions in Federal agency issues for the purpose of gaining experience. He hoped to distribute a memorandum on that subject to the Committee before the next meeting.[1/]

Mr. Hayes said he had substantial reservations concerning the wisdom of System operations in Federal agency securities, at least in the near future. Although he agreed that the question should now be explored with the new Treasury officials, he recalled that there had been little enthusiasm for the idea among either System or Treasury officials serving on the Steering Committee. At the time of their review, members of the Steering Committee had indicated that certain of their technical reservations would be reduced if individual Federal agencies were to consolidate their new issues into fewer but larger offerings. Such consolidation would make larger and

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1/ Mr. Robertson's memorandum was distributed to the Committee on May 5, 1969. A copy has been placed in the Committee's files.

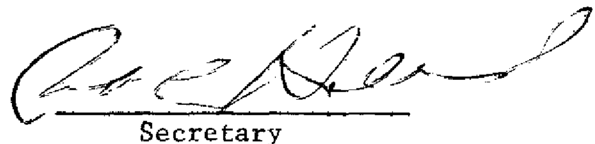
more tradeable blocks of individual issues available in the market and would thus reduce the risk that System operations would have undesired effects on prices. For the present, he favored publication of the Steering Committee report as soon as feasible, bearing in mind that such publication had already been long delayed.

The members then discussed the precise responsibility of the Federal Open Market Committee for the Steering Committee's report. Chairman Martin suggested that the editorial changes being drafted by Mr. Axilrod should be circulated to the Steering Committee for its approval.[1] He (Chairman Martin) proposed that, contingent upon such approval, the Federal Open Market Committee authorize the publication of the Steering Committee's report.

There were no objections to the Chairman's proposal.

It was agreed that the next meeting of the Committee would be held on Tuesday, May 27, 1969, at 9:30 a.m.

Thereupon the meeting adjourned.



Secretary

1/ Copies of a memorandum from Mr. Axilrod on this subject were distributed to the Steering Committee, and for information to the members of the Open Market Committee, on May 1, 1969. A copy has been placed in the Open Market Committee's files.

ATTACHMENT A

CONFIDENTIAL (FR) April 28, 1969

Draft of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on April 29, 1969

The information reviewed at this meeting suggests that expansion in real economic activity has moderated slightly since the fourth quarter of 1968, while substantial upward pressures on prices and costs are persisting. Long-term interest rates have generally declined in recent weeks, but most short-term rates have risen somewhat. In the first quarter of the year bank credit changed little on average and the money supply grew at a sharply reduced rate, but in early April both measures increased substantially, partly as a result of temporary factors. The outstanding volume of large-denomination CD's has continued to decline and there was a net outflow of consumer-type time and savings deposits from banks and other thrift institutions in the first half of April. A sizable deficit reemerged in the U. S. balance of payments on the liquidity basis in the first quarter but the balance on the official settlements basis remained in surplus as a result of large inflows of Euro-dollars. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the reduction of inflationary pressures, with a view to encouraging a more sustainable rate of economic growth and attaining reasonable equilibrium in the country's balance of payments.

To implement this policy, while taking account of the forthcoming Treasury refunding, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the prevailing firm conditions in money and short-term credit markets; provided, however, that operations shall be modified, to the extent permitted by the Treasury refunding, if bank credit appears to be deviating significantly from current projections.