

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 7, 1970, at 9:30 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Brimmer
Mr. Daane
Mr. Francis
Mr. Heflin
Mr. Hickman
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Sherrill
Mr. Swan

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

Messrs. Eastburn, Clay, and Coldwell, Presidents
of the Federal Reserve Banks of Philadelphia,
Kansas City, and Dallas, respectively

Mr. Holland, Secretary
Mr. Broida, Deputy Secretary
Messrs. Kenyon and Molony, Assistant
Secretaries
Mr. Hackley, General Counsel
Mr. Partee, Economist
Messrs. Axilrod, Craven, Gramley, Hersey,
Hocter, Jones, and Solomon, Associate
Economists
Mr. Holmes, Manager, System Open Market Account

Mr. Bernard, Assistant Secretary, Board of
Governors
Mr. Cardon, Assistant to the Board of Governors
Messrs. Coyne and Nichols, Special Assistants
to the Board of Governors

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Messrs. Wernick and Williams, Advisers,
Division of Research and Statistics,
Board of Governors
Mr. Keir, Associate Adviser, Division of
Research and Statistics, Board of
Governors
Mr. Wendel, Chief, Government Finance Section,
Division of Research and Statistics,
Board of Governors
Miss Ormsby, Special Assistant, Office of the
Secretary, Board of Governors
Miss Eaton, Open Market Secretariat Assistant,
Office of the Secretary, Board of Governors

Mr. Baughman, First Vice President, Federal
Reserve Bank of Chicago
Messrs. Eisenmenger, Link, Taylor, and Tow,
Senior Vice Presidents, Federal Reserve
Banks of Boston, New York, Atlanta, and
Kansas City, respectively
Messrs. Bodner, Monhollon, Scheld, and Green,
Vice Presidents, Federal Reserve Banks of
New York, Richmond, Chicago, and Dallas,
respectively
Mr. Gustus, Economic Adviser, Federal Reserve
Bank of Philadelphia
Mr. Meek, Assistant Vice President, Federal
Reserve Bank of New York
Mr. Herder, Assistant Research Director,
Federal Reserve Bank of Minneapolis

By unanimous vote, the minutes of
actions taken at the meeting of the
Federal Open Market Committee held on
March 10, 1970, were approved.

The memorandum of discussion for
the meeting of the Federal Open Market
Committee held on March 10, 1970, 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

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period March 10 through April 1, 1970, and a supplemental report covering the period April 2 through 6, 1970. Copies of these reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Bodner said the Treasury gold stock remained unchanged, as it had since early January. At the same time, there had been very few official gold transactions and so the Stabilization Fund remained well supplied, with its holdings at over \$500 million. The private gold market, on the other hand, had been somewhat more active than it had been in recent months, and with demand running at higher levels the price had tended to move up. After hitting \$35.40 last week, the price had eased a bit, and this morning it was \$35.30. Indications were that the rise in demand reflected the higher level of tensions in the Middle and Far East in recent weeks. As the price began to move up the usual pattern of dwindling supply developed, as potential sellers began withdrawing to see how far the market would move. South Africa continued to supply gold during most of the period, however, and there were no signs that the South African payments position had improved sufficiently to permit them to withhold any significant quantities from the market. Nevertheless, with the bulk of the supply overhang from 1968 now surely having been worked off, a continuation of prices above \$35 was to be expected.

Mr. Bodner reported that the exchange markets had remained quite active, with the dollar generally tending to weaken somewhat

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in orderly trading. With the Euro-dollar market a bit easier-- and, in particular, with U.S. banks less active bidders for funds in Europe while most European money markets remained very tight-- the continuing large liquidity deficit of the United States had been reflected in both the exchange markets and U.S. official settlements. With their own positions strengthening at the same time, the British, French, Canadians, and Japanese made sizable reserve gains; the Belgians and Dutch made more modest gains; and the Italian losses slowed appreciably. For the most part, those developments had been welcome in that they had permitted the further reduction of Treasury claims on Britain and France and had made it possible for the Italians to forego for the moment further drawings on the swap line. On the other hand, the Federal Reserve had had to draw additional Belgian francs and it had made no progress in reducing the outstanding indebtedness to the Dutch.

Mr. Bodner commented that the cut in the Bank of England's discount rate that preceded the last meeting of the Committee narrowed the large incentive that had developed in favor of short-term investments in sterling and pretty much brought to an end the inflow of interest-sensitive money that had emerged. The underlying U.K. payments situation continued to be favorable, however, and so sterling had remained strong. Moreover, the London market was very tight throughout March and British companies that had been holding excess funds abroad continued to bring them home. In addition, a

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number of firms with foreign subsidiaries had to repatriate funds for tax payments as well as for the usual quarter-end payments.

Consequently, Mr. Bodner continued, sterling recovered fairly quickly from the dip following the cut in Bank rate, and from another dip following release of the February trade figures--which showed the first deficit in seven months. The Bank of England took in dollars throughout the month and in the end the gain was almost as large as in February, some \$840 million. The bulk again was devoted to debt repayment. The last \$200 million of Treasury overnight credits were dispensed with, as had been agreed earlier, and there was no need for backstopping by the System. In addition, \$175 million was repaid to the Bank for International Settlements of the \$250 million borrowed in February to permit repayment of debt to the System. Thus, only \$75 million--now scheduled for repayment in May--remained of the BIS credit, which the System had agreed to backstop if necessary.

At the same time, Mr. Bodner observed, the British made further repayments of credits under the November 1967 post-devaluation package. The final \$225 million owed to Canada, Japan, and Germany was repaid and the Treasury received \$125 million, reducing its credit to \$225 million. In addition, a net of \$50 million was paid to the International Monetary Fund. Thus, since September the British had used inflows to repay some \$3.1 billion in short-term debt, and thus far in April they had taken in another

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\$100 million. That performance had been heartening, and it certainly was better than most people had thought possible. It would give the Government a bit more leeway in the budget that was coming up next week than it might otherwise have had, but the markets--especially on the continent--would be watching closely to see just how much relaxation occurred. The legacy of the past years was continued doubt; while the British themselves seemed to have recovered their self-confidence, their neighbors remained unconvinced.

Mr. Bodner commented that the Committee had last met just after the Germans raised their discount rate to 7-1/2 per cent. Mr. Coombs had noted at that meeting that despite the fact that the German Federal Bank had introduced a reserve requirement against new foreign deposits at banks, there remained the possibility of substantial borrowings of Euro-dollars by German industry as well as of a reduction in long-term capital outflows from Germany. That pattern, in fact, did emerge over the past month and as a consequence the mark rate had moved up quite sharply. The Federal Bank permitted the rate to rise through par without intervening in the market until yesterday, when--the mark having moved significantly above par--it began to purchase dollars for the first time since revaluation. The Federal Bank took in some \$65 million yesterday and today. That reserve gain was important not for its size, but because it

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indicated that the Germans might once again be facing the problem of trying to fight inflation with monetary policy during a period in which their interest rates were at or above rates abroad. In the absence of effective fiscal action the Germans might yet find that revaluation alone would not make monetary policy effective, and some restrictions on the freedom of nonbanks to borrow in the Euro-dollar market could become necessary--even though the Germans were reluctant to take such measures.

As he had noted earlier, Mr. Bodner continued, the Bank of Italy's reserve losses had tapered off somewhat over the past month, especially since the formation of the Rumor Government. In fact, on a number of days recently there had been net gains. The reduction in the rate of loss, plus the infusion of some private foreign funds through borrowings by Italian official entities, meant that the Italians did not have to draw further on the swap line; their drawings remained at \$800 million. Nevertheless, although the lira was now beginning to enter a seasonally strong period, the rate remained close to the floor and some intervention was often still necessary. By and large, however, the market was calmer and certainly among New York dealers there was fairly general confidence in the lira.

In conclusion, Mr. Bodner said, he should mention the relative firmness that persisted in the Euro-dollar market despite the easing of money market pressures in New York. It was true that

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most of the major U.S. banks so far had been reluctant to see their Euro-dollar borrowings drop below the base figures. However, the principal demands in the Euro-market at the moment seemed to be coming not from U.S. banks but rather from European banks and firms, reflecting the continued very tight money markets in most of the major European centers. Thus, Euro-dollar rates had come down only slightly from the levels prevailing at the time of the last meeting, to about 8-9/16 per cent for three-month money. Shorter maturities tended to be even firmer.

By unanimous vote, the System open market transactions in foreign currencies during the period March 10 through April 6, 1970, were approved, ratified, and confirmed.

Mr. Bodner noted that two System drawings on the National Bank of Belgium, for \$12.5 million and \$17.5 million, respectively, would mature for the first time in early May. The Belgian franc had generally continued strong through recent months; indeed, since the last meeting the System had had to make an additional \$20 million drawing, bringing total System commitments in Belgian francs to \$105 million. The swap line had been in continuous use since November 25, 1969. Although the Belgian franc had weakened yesterday and it might be possible to begin paying down those commitments, it was not likely that they would be liquidated by maturity. Therefore, he recommended renewal of the two drawings at maturity.

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Renewal of the two System drawings on the National Bank of Belgium was noted without objection.

Mr. Bodner reported that a \$130 million System drawing on the Netherlands Bank would mature for the second time on April 29. There had been no opportunity to acquire guilders in the last month or so, and the prospects for the next month were slim. Accordingly, he recommended a second renewal of that drawing. He noted that the Dutch swap line had been in continuous use since October 22, 1969, and said that he had asked the Treasury to begin looking into possible means for acquiring the guilders the System would need to liquidate the drawing.

Renewal of the System drawing on the Netherlands Bank was noted without objection.

Mr. Bodner observed that the first two \$200 million drawings by the Bank of Italy on the System would be maturing for the first time in late April and early May. Although the Italian situation seemed to be improving, it was most unlikely that the Bank of Italy would be in a position to repay those drawings at their maturity. Therefore, he recommended their renewal if that was requested by the Bank of Italy.

Renewal of the two \$200 million drawings by the Bank of Italy was noted without objection.

Mr. Bodner then noted that on March 23, 1970, Mr. Coombs had submitted to the Committee a memorandum entitled "Recommended

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changes in paragraphs 1B(4) and 1C(2) of the authorization for System foreign currency operations,"^{1/} which had been prepared in response to a question Mr. Coldwell had raised at the meeting of the Committee on March 10. Mr. Coombs recommended deleting paragraph 1C(2), which authorized technical forward commitments in Italian lire. As Mr. Coombs noted, the Bank of Italy had no objection to such a step. The other affected paragraph--1B(4)--authorized System holdings of up to \$300 million equivalent of guaranteed sterling. The Special Manager recommended an amendment of that paragraph to reduce the limit to \$200 million, where it had been prior to the increases of April and May 1968. The System's holdings of guaranteed sterling had recently been reduced to \$199 million through sales to the U.S. disbursing officer in London and to the Bank of England. While those holdings might be reduced further in coming months, the Special Manager had no present plans to recommend further reductions in the limit. The Bank of England had no objection to lowering the limit to \$200 million at this time.

In response to Chairman Burns' question, Mr. Coldwell said he would favor approving the Special Manager's recommendations.

By unanimous vote, paragraphs 1B and 1C of the authorization for System foreign currency operations were amended to read as follows:

^{1/} A copy of this memorandum has been placed in the files of the Committee.

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B. To hold foreign currencies listed in paragraph A above, up to the following limits:

(1) Currencies purchased spot, including currencies purchased from the Stabilization Fund, and sold forward to the Stabilization Fund, up to \$1 billion equivalent;

(2) Currencies purchased spot or forward, up to the amounts necessary to fulfill other forward commitments;

(3) Additional currencies purchased spot or forward, up to the amount necessary for System operations to exert a market influence but not exceeding \$250 million equivalent; and

(4) Sterling purchased on a covered or guaranteed basis in terms of the dollar, under agreement with the Bank of England, up to \$200 million equivalent.

C. To have outstanding forward commitments undertaken under paragraph A above to deliver foreign currencies, up to the following limits:

(1) Commitments to deliver foreign currencies to the Stabilization Fund, up to the limit specified in paragraph 1B(1) above; and

(2) Other forward commitments to deliver foreign currencies, up to \$550 million equivalent.

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 March 10 through April 1, 1970, and a supplemental report covering the period April 2 through 6, 1970. Copies of both reports have been placed in the files of the Committee.

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

Short-term interest rates on balance declined sharply over the period since the last meeting of the Committee, bringing Regulation Q ceilings on large CD's into a competitive range for the first time in many months. And of course the prime rate was reduced by 1/2 percentage point on March 25. Treasury bill rates tended to back up somewhat in the latter half of the period, reflecting seasonal shifts in demand patterns and the very substantial inventories built up by dealers in anticipation of an easing in monetary policy and of renewed seasonal demand later this month. In yesterday's auction, average rates of 6.41 and 6.45 per cent were established for 3- and 6-month Treasury bills, respectively, 47 and 28 basis points below the rates established in the auction just preceding the last meeting of the Committee.

Long-term interest rates fluctuated rather sharply over the period, as the capital markets were buffeted by shifting expectations affecting the demand for bonds in a period of a heavy supply of corporate, municipal and Federal agency issues. Early in the period a heavy supply of new issues met with an indifferent investor response, and by March 18 there was considerable congestion in both the corporate and municipal markets. Prices declined sharply as a number of syndicates with a large volume of unsold new issues were terminated in a deteriorating market atmosphere.

A sharp turnaround was generated, however, by Chairman Burns' testimony on the 18th before the Senate Banking Committee. The Chairman's remarks were widely interpreted in the market as confirmation that monetary policy had already been relaxed and that some further relaxation might be at hand as the Federal Reserve guarded against recessive tendencies in the economy. Bond prices recovered promptly, and the unsold backlog of new issues was cleaned out.

At the moment, the market attitude is on the rather cautious side. With a cut in the prime rate now a matter of history, market participants are finding it more difficult to visualize what kind of favorable developments might take place in the immediate future. To be sure, a seasonal decline in short-term rates is expected after

the April tax date, but dealers have already built up their Treasury bill portfolios in anticipation of that. Generally speaking, there appears to be less fear than existed a few weeks ago that a cumulative downward movement of the economy might be under way. There is, however, growing concern that fiscal policy may be becoming overly stimulative, and recent wage negotiations have certainly done little to quell fears of inflationary price developments in the future.

Monetary policy, as usual, is under particularly close scrutiny. Many market participants feel that, outside of some seasonal decline in short-term rates, not much can be expected in the way of further monetary ease in the immediate future. These observers see money supply beginning to grow again after a long period of stagnation and recognize that, with CD's having become more competitive with market rates, commercial banks are under considerably less pressure. To them, the System is apt to be cautious about pushing further towards ease-- at least in the absence of further signs that the economy is weakening. There are some, however, who read into some recent official statements the likelihood of continuing official moves towards lower interest rates and a more rapid growth of the money supply. Consequently, our day-to-day operations will be under close scrutiny by the markets, as will the unfolding statistical performance of the money supply and bank credit and of the economy in general.

Open market operations over the period were directed towards achieving the Committee's desires for moderate growth in the aggregates. I am sure that we have a great deal to learn about operating under an aggregative directive. Also, we are still seeking out the best way of presenting the statistical material that we have found useful in day-to-day operations, and I would appreciate any suggestions that the Committee members, or their staffs, may care to make. And then there are the perennial problems of how much weight to give to the projections, of which we are all skeptical; how much weight to give to weekly statistics, which tend to be quite jumpy; how to interpret divergent trends in the aggregates with which we are most concerned; and how far to push money market conditions if the aggregates are misbehaving. These, and a host of other questions, I am sure can only be answered after we have gained more experience, but I would welcome any guidance members of the Committee may care to provide.

Over the period since the Committee last met, the aggregates have on balance turned out close to the Committee's desires. Both the adjusted credit proxy and money supply showed substantial growth in March. Over the first quarter as a whole, the credit proxy rose at an annual rate of about 1/2 per cent and money supply, strongly influenced by an unexpectedly strong surge over the long Easter holiday in Europe, rose at about a 3 per cent rate. Early in the period, it appeared that the credit proxy--while still projected at a 7-1/2 per cent annual growth rate in March--would fall short enough of earlier expectations to bring about a small decline in the proxy over the first quarter rather than the small rise projected at the last meeting--a rise which appeared acceptable to the Committee. While we probably should not--in normal circumstances--pay too much attention to small deviations from targets, the difference between a rise and a fall appeared significant enough to warrant attention, and we began to move towards somewhat less firm money market conditions.

As the period progressed and short-term interest rates--influenced more by shifting expectations than by our operations--declined sharply, it appeared that banks would be readily able to expand time deposits. As banks began to place large CD's--first with dealers who built up speculative positions of over \$300 million and then with other domestic investors, mainly public funds--and as the credit proxy got back on track, there appeared to be no reason to let money market conditions ease further.

The blue book^{1/} for this meeting contains a most interesting analysis of the likely development of money supply and bank credit under the alternative directives,^{2/} involving different assumptions about interest rates and Desk operations. As I understand it, alternative A provides for levels of money supply and bank credit in June

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

^{2/} The alternative draft directives submitted for the Committee's consideration are appended to this memorandum as Attachment A.

similar to those acceptable to the Committee at the last meeting. Since interest rates have declined more than anticipated four weeks ago, there is a strong likelihood that--assuming only a seasonal decline in short-term rates--the credit proxy will grow more rapidly than earlier expected as banks expand CD's. If this is not acceptable to the Committee, the Desk might have to exert upward pressure on money market rates to counteract developing seasonal pressures that are tending to push short-term interest rates lower. I might note that such action--particularly if it had to be implemented soon--might provide a wrench to expectations that dealers will be able to work down their swollen bill inventories as seasonal demands increase later this month. And expectations will be an important consideration for the Treasury as it gets set to announce the terms of its May refunding later this month.

But the blue book analysis points up the fact that, as large CD's become competitive with market rates, the stage will be set for a possibly explosive reentry of commercial banks into the process of intermediation. There may well be some offsets--perhaps major ones--as banks pay off Euro-dollars (the major question here being how highly they value holding onto their reserve-free base) and other high cost borrowings rather than expand assets. The possibility that bank credit might expand much more rapidly than projected under alternative B of the directive cannot be ignored, and it would be most helpful to have the Committee's views on the trigger point for resistance. So far I have been working on the assumption that the Committee wants to put roughly equal weight on the money supply and bank credit, and if the Committee has other views it would be helpful to have them.

I might note in passing that projections for the second quarter at the New York Bank--based on the assumption that some normal seasonal decline in interest rates will in fact take place--are relatively close to the blue book's projections for alternative B, although we would have the credit proxy growing at an annual rate of 7-1/2 per cent rather than 6-1/2 per cent. For April alone we are projecting a 10-1/2 per cent growth rate for the credit proxy compared to 8 per cent by the Board staff, but we have money supply growing by only 1 per cent compared to 4 per cent on the Board staff estimate.

At the moment, the staffs are producing a welter of statistics and projections designed to permit the Committee to focus on the aggregates. I trust that in the process we will not mislead ourselves into thinking that we have developed rigid numerical targets that must be achieved at all costs. We are asking a great deal of our projectors these days, and it is by no means clear that the state of the forecasting art can deliver a wholly usable product. Unless I am instructed otherwise, I would plan to proceed promptly but cautiously to shift money market conditions in an appropriate direction as cumulative evidence about the behavior of the aggregates develops. In the process, however, I believe we have to pay close attention to the effect of our operations on market expectations and try to avoid any unnecessary whip-sawing of the markets in an effort to offset in the very short run what may really turn out to be random deviations in the aggregates from expected patterns.

In conclusion, I might note that the System holds \$11.6 billion of the total \$16.5 billion of Treasury notes maturing on May 15. Should the Treasury offer a choice of issues, as appears likely, I would plan to divide the System subscription among the issues offered proportionately to the anticipated public subscriptions.

Mr. Hickman observed that the projections of the monetary aggregates for the individual months of the second quarter and for the individual weeks of April were shown in the current blue book in the form of point estimates of dollar levels. That was in contrast to the earlier procedure, in which the projections had been expressed in terms of annual rates of change, rather than dollar levels; and as ranges, rather than point estimates. In his judgment the earlier procedure was preferable, and the change represented a step backward.

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Mr. Holmes said he also thought it was helpful to have the projections in the form of rates of change. With respect to the point estimates shown, the blue book noted that deviations were likely and should be acceptable if not cumulative in one direction. He hoped members of the Committee would indicate their desires with respect to tolerable deviations.

Mr. Axilrod commented that the figures for the second quarter as a whole and for the month of April were expressed in the form of percentage changes as well as dollar levels; it was the figures for later months of the quarter, and for the weeks of April, that were shown only in terms of dollar levels. The staff had thought that showing annual rate figures for, say, May and June might be more confusing than helpful. The reasoning was that the Committee was more interested in behavior of the aggregates over the quarter than in individual months, and would want any deviations from the indicated growth rates for April offset by adjustments in the target growth rates for later months of the quarter. If that reasoning was correct, targets for May and June expressed on an annual rate basis were likely to fluctuate rather widely in reflection of changes in the estimates of realized dollar levels for April.

Mr. Axilrod added that the percentage changes shown for April and the second quarter were intended as midpoints of ranges of about the width used in the past--that is, plus or

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minus 1 or 1-1/2 percentage points. If the Committee so desired, data on possible targets in the form of ranges of percentage changes could be included in future blue books.

Mr. Hickman said he would favor such a course.

Mr. Daane referred to the Manager's request for guidance regarding the trigger point for resisting the expected seasonal decline in short-term interest rates, and asked what the consequences might be if no resistance were offered.

Mr. Holmes replied that the rate of reintermediation would, of course, be faster than otherwise. However, the consequences for bank credit growth would depend largely on the use to which banks put the funds gained, and that was hard to predict. His purpose was simply to note the possibility of a sharp rise in bank credit--such as had occurred in some past periods of reintermediation--and to ask how the Committee would want him to respond if such a rise eventuated now.

Mr. Francis said that in the short run--and perhaps in the longer run also--he would favor giving most weight to the money stock. As the Manager had noted, declines in short-term rates might touch off substantial reintermediation and rapid growth in bank credit. If the Manager was instructed to restrain bank credit expansion under such circumstances the growth rate of the money stock was likely to fall short of the Committee's desires.

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Mr. Brimmer commented that the question could be formulated in terms of opposing risks. A failure to resist declines in short-term rates would risk unduly rapid growth in bank credit. On the other hand, an effort to keep growth in the bank credit proxy within the neighborhood of the rate associated with alternative A by exerting upward pressure on money market rates would risk disappointing market expectations. The magnitude of the risk that bank credit growth would be excessive depended in part on the degree to which banks were prepared to defend their reserve-free bases of Euro-dollar borrowings. At least until more was known on that score he would want to proceed cautiously, and would therefore prefer to incur the risk of disappointing market expectations. Accordingly, he thought the Manager should be instructed to put more weight on the adjusted bank credit proxy than on the money stock.

Mr. Mitchell noted that the 3.2 per cent growth rate for the money stock in the first quarter was impressively close to the rate the Committee had indicated at its January meeting that it desired. While that success was attributable in part to the Desk's operations, in part it reflected fortuitous technical factors, including an end-of-March bulge, that would not be operative in the second quarter. That suggested to him that the Desk would have to work harder in the second quarter than it had in the first to achieve moderate growth in money.

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He asked how the Manager viewed the prospects for success in that effort.

In response, Mr. Holmes observed that both the Board and the New York Bank were now projecting moderate growth in money in the second quarter after allowing for the bulge at the end of March. It was true that their projections differed for individual months; for example, the growth rate for April projected at the New York Bank was 1 per cent, whereas the Board projection was for a 4 per cent growth rate.

Chairman Burns asked about the precise meaning of the word "projection" in that context.

Mr. Holmes responded that the numbers prepared at the New York Bank represented the staff's best current judgment of the likely performance of the aggregates, given certain assumptions about prospective interest rate movements and information on past seasonal patterns. The projections were conditional in the sense that they were subject to continual revision on the basis of new developments.

Mr. Axilrod remarked that the numbers shown in the blue book in connection with alternatives A and B for the directive were intended not as projections but as alternative sets of target paths for the several monetary aggregates which, hopefully, were internally consistent and which were offered for consideration by the Committee.

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Chairman Burns commented that the two staffs evidently had quite different conceptions of the numbers in question. In his judgment the emphasis should be on targets for the financial aggregates, in light of what was known--or thought to be known--about the course of the economy.

Mr. Holmes agreed that the blue book numbers were accurately described as targets. He thought, however, that there was also an important role for projections, in the sense he had defined them, for use in determining during the course of a period whether the aggregates were on track with respect to the targets for that period.

Mr. Maisel remarked that the subject under discussion had been carefully examined by the committee on the directive, whose report was scheduled for consideration later in today's meeting. If the Open Market Committee's decisions were formulated in terms of maintaining certain money market conditions subject to a bank credit proviso, projections of bank credit were required to enable the Manager to interpret the proviso. However, those projections had proved to be the weak link in the process. In the judgment of the directive committee, the Open Market Committee should formulate its objectives directly in terms of target growth rates for the monetary aggregates. That procedure should not only result in better policy formulation but it should also reduce certain operating problems. A case in point was the concern the

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Manager had expressed today about the possible wrench to market expectations if he were required to tighten money market conditions during a Treasury financing. That was a legitimate concern so long as the market thought a change in money market conditions in itself signified a change in monetary policy. If, however, the market was aware that the Committee was specifying its targets in terms of aggregative growth rates, fluctuations in money market conditions would not be likely to have any important impact on market psychology.

Mr. Brimmer observed that the Open Market Committee had not yet acted on the report of the directive committee and said he thought it would be unwise to respond to the Manager as if the recommendations of that report had been adopted. Aside from that, however, he believed the Manager should be given guidance on operating strategy as well as on targets; the Committee should take responsibility for the choice of strategy, since the decision could have significant implications for developments. Although he agreed that the Committee should have clearly defined targets, he thought it also would find projections necessary for the purpose of deciding on strategy.

Mr. Daane said that while he agreed that the Committee should set targets for the aggregates, he would not favor formulating them in highly precise terms. In his judgment, undue

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precision with respect to targets could create operating problems by giving the Manager insufficient leeway to adapt to particular circumstances.

Chairman Burns remarked that precise specification of a target did not necessarily mean that a high degree of marksmanship was expected. However narrowly the Committee defined its goals for the aggregates, it presumably would expect to be tolerant of the inevitable misses. Also, the Committee would want to give the Manager some room for maneuver; the fact that it stressed its goals for the aggregates did not mean that it wanted the Manager to ignore money market conditions. The Committee could either specify a precise target on the understanding that it did not expect precise performance, or it could specify an acceptable range of outcomes. While he leaned toward the former procedure, he thought the two came to much the same thing.

Mr. Daane said his inclination would be to specify a range and to be tolerant of deviations.

Mr. Hayes observed that he personally would prefer to use reasonably wide ranges for target purposes. In his judgment not enough was known regarding the linkages between the behavior of the aggregates and the extent to which the ultimate objectives of policy were met to warrant precise specification of targets for the aggregates. He could not be sure, for instance, that

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a 2.8 per cent rate of growth in the money stock was more likely to result in sustainable economic growth without inflation than was a 3.4 per cent rate.

Mr. Morris said he would like to underscore the point that setting targets for the aggregates did not obviate the need for projections. The latter were still necessary for the purpose of describing the path by which a particular target might be reached. In his judgment it was not wholly fortuitous that money supply growth in the first quarter had been so close to the target; in good part that outcome resulted from the fact that the staff had provided the necessary "road map" in the projections contained in preceding blue books.

Chairman Burns agreed that projections of aggregates were useful in formulating judgments as to whether target growth rates were being attained, but he thought a close knowledge of unfolding developments was also useful for that purpose. How one combined the two was a matter of personal preference. In the past he had found projections to be an uncertain guide and sometimes misleading. Accordingly, he was inclined to put more weight on history than were, for example, some members of the Board's staff.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period March 10 through April 6, 1970, were approved, ratified, and confirmed.

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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.

Mr. Partee made the following statement concerning economic developments:

Since the last meeting of the Committee there has been a shift in the staff's view of the economic outlook. Mainly this reflects the potential impact of the earlier dating and partly retroactive character of the Federal pay raise, which developed suddenly in the aftermath of the postal strike. The raise would add appreciably to total income and prospective consumption expenditures for the balance of the calendar year, even if largely compensated for over the fiscal year in budgetary terms by adoption of the new revenue measures proposed. In addition, however, the business statistics of recent weeks had already suggested to us that the downward adjustment might not last so long as seemed most probable a month or two ago. The primary evidence on this point was the sharp decline in total business inventories reported for January. This, along with the February strengthening in new orders, suggested more progress in working off excess stocks than we had anticipated.

The implications of these developments for the economy, as we see them, are illustrated by the revised GNP projection tables distributed to you yesterday. More rapid expansion in current dollar GNP is projected to resume this quarter, when the combination of higher Federal expenditures resulting from the retroactive pay raise, larger consumption, and a somewhat smaller inventory drag is expected to lift the GNP increase to around \$16 billion. But the projected rate of expansion continues somewhat faster in the second half of the year too, with the result that by the fourth quarter we now expect the level of GNP to be \$10 billion higher than we had estimated in the February chart show.

In real terms, the change in the projection is less dramatic. This is partly because the initial impact of the Federal pay raise is reflected entirely in the GNP

deflator, and partly because we assume that stronger growth in nominal GNP will mean slightly less progress on the price front than expected earlier. We now estimate that the GNP deflator will be rising at a 3.6 per cent annual rate in the fourth quarter, one-tenth of a point more than before, and that for 1970 as a whole it will average 4.7 per cent above 1969, three-tenths of a point more than projected in February. Real GNP is now expected to rise slightly in the second quarter and to grow at around a 3 per cent annual rate, on average, in the last two quarters of the year.

Since projected real GNP expansion is still below our growth potential, unemployment may continue to creep up even in the second half. We are now estimating a fourth-quarter unemployment rate of 4.8 per cent, down from the 5.1 per cent projected in February. For these and other reasons, we have left unchanged our earlier assumption of moderate monetary growth over the balance of the year--4 per cent in money and around 7 per cent in total bank credit. This is an essential ingredient in the expected upturn of housing after mid-year and, to a lesser extent, of the relative strength in State-local construction, which remain features of our projection. With GNP growth stronger, of course, interest rates would be somewhat higher than in our February projection, but we still assume that savings flows to the financial intermediaries will improve, as they have recently.

Whether or not these estimates are "on target", the new and stronger pattern of growth in GNP and related indicators does seem to me to represent a reasonable change to make in our expectations at this time. On the one hand, it now seems clear that economic weaknesses are unlikely to cumulate into a downward spiral. Not only the inventory numbers, but also the less rapid rise recently in insured unemployment and the continuing relatively slow decline in industrial output suggest that downward forces have not been gathering strength. Personal income has continued to grow at a moderate rate throughout the period, and we are now at the point where additional income supplements--including social security payments as well as the Federal pay raise--should begin to stimulate consumer demands.

At the same time, it is important to note that the evidence we have in hand suggests that the performance of the economy has continued relatively weak right up to the present. Domestic new car sales dropped back again

in March, to a 7.3 million annual rate, and the weekly data indicate continuing sluggishness in retail sales generally last month. Very partial information suggests a further small drop in industrial production for March, and the available labor market indicators continue generally weak. The regular monthly employment series have been delayed by the slowness of the mail, but on a preliminary and very confidential basis we have been informed that the unemployment rate for March moved up further, to 4.4 per cent. All of the increase, as in February, was among adult workers.

Hence, if the prospects are now for some strengthening in the economy, but with real growth still proceeding at a moderate rate, this would be a most encouraging and desirable development. It would reduce the pressures for more stimulative economic measures, and would be consistent with the Committee's policy of achieving only moderate monetary expansion. It may well be that the postal strike and Federal pay concessions have intensified the problem of upward pressures on costs in the private sector. But it is apparent also that aggregate demands in the economy remain well below our current production potential. Moreover, there seems to me little basis at present for expecting that a new boom is about to be generated. Federal defense spending is projected to be declining significantly for many months to come and consumers, judging by the latest surveys, are still in a conservative--even pessimistic--mood. I continue to believe, also, that capital spending is much more likely to fall short of expectations than to strengthen in the period ahead.

There is a possibility, of course, that evidence of an improving business trend and a strengthening again of inflationary expectations could interact, bringing an undesirable acceleration later on in demands for goods. Such a development might well be preceded by an intensification in the demand for credit, and we should be watchful that our expectations for growth in money and credit are not significantly exceeded. But I can see no reason now for altering the Committee's policy of encouraging moderate rates of monetary growth over the months ahead. Indeed, alternative B comes closer than A in targeting rates of expansion in money and bank credit consistent with our February chart show assumptions.

Mr. Axilrod made the following statement concerning financial developments:

The course of policy set in motion by this Committee appears to be being achieved, at least as measured by growth in certain key monetary aggregates. As the blue book notes, in March we have seen somewhat greater deposit flows into banks than indicated at the last FOMC meeting, but this has been accompanied by a sizable net repayment of nondeposit sources of funds, particularly Euro-dollar borrowings. Thus, banks have already begun to replace relatively high cost borrowings with lower cost time deposit funds, which, of course, provides some rationale for the recent 1/2 point reduction in the prime loan rate. Because of this substitution of time deposits for other bank sources of funds, the average level of the adjusted bank credit proxy in March was just about as indicated at the last Committee meeting. The money supply growth for March was larger than indicated, largely as a result of a bulge in the last week of the month, and I will have some comments on this at a later point.

While banks have evidently begun to reduce their average cost of money, they also seem to be rebuilding liquid asset positions, as one might expect to happen before they relax lending standards and nonrate terms significantly. Our estimates of the change for March in total loans and investments of banks show the first monthly increase in banks' holdings of U.S. Government securities since last summer. An even more notable figure in the March statistics was the over \$1-1/2 billion increase in banks' acquisitions of other securities--the largest monthly rise since late 1968. This appears to reflect, according to market reports, acquisitions of liquid short-term municipal securities in addition to speculative positioning by dealer banks of longer-term municipals.

How soon banks ease lending conditions will depend critically on the state of loan demands, as well as on banks' liquidity preferences. With regard to loans, the March data are also surprising. They show an actual decline in outstanding business loans of banks, even after allowance is made for loans sold. This result does not exactly square with reports from many banks that loan demands remain generally strong, but it does seem consistent with our estimates of a greatly reduced rate of business inventory accumulation. A tentative conclusion

might be reached that, in the winter quarter, there was some abatement of business loan demands, and short-term credit demands generally, as suggested by the very preliminary first-quarter flow-of-funds figures in the green book.^{1/} But one would feel considerably more comfortable in this conclusion if the March figures on total commercial paper borrowing by nonbanks were available.

While the position of banks is becoming less pressed, certainly as far as the supply of funds to them is concerned and possibly to a degree insofar as demands on them are concerned, the condition of nonbank thrift institutions, and the mortgage market generally, is a little more difficult to fathom at this time. The February data showed an improvement in savings flows, and preliminary data for March show quite a substantial further improvement for savings and loan associations. As to experience in the current reinvestment period, the limited daily data we have indicate that mutual savings banks are faring worse than last year, but that S&L's, at least as judged by the three March grace days, are not doing badly--in fact, they are doing a little better than in March of 1969. It appears that these institutions, like banks, want to rebuild liquidity positions--and S&L's have recently acquired U.S. Government securities and repaid Federal Home Loan Bank advances. Unfortunately, we do not have any data beyond February on mortgage commitments, but with recent credit market developments creating a sense that mortgage rates may be topping out, there have been reports that some S&L's and mutual savings banks have been seeking out residential mortgages for immediate purchase--perhaps a harbinger of greater commitment activity if the reinvestment period does not turn out too badly and is followed by a reasonable expansion in net savings inflows.

Turning now to the money supply, the late March rise of around \$4-1/2 billion on the preliminary figures gives a growth rate for the quarter of a little over 3 per cent. The question naturally is: how much of this is real and how much a statistical artifact? Of the \$4-1/2 billion, our best estimate is that about \$2 billion--on a daily-average basis for the week--are

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

related to the 4-day holiday abroad, or about the same as in last December. As to the remainder of the end-of-March money supply growth, it appears to have been fairly widely distributed around the country and may be explainable on two grounds: One would be a considerably larger than seasonal drop that appears to have developed in U.S. Government deposits (after abstracting from the effect on Government deposits of payment by banks for tax bills on March 26 through tax and loan credits), and another would be possible credit demands from businesses whose receipts were held up by the mail strike and air slowdown. It should also be noted that there was an unusually sharp rise in total loans at New York City banks during the last week in March, with the rise concentrated in loans to finance companies and security dealers--loans which in the past have often reversed themselves in relatively short order. On the basis of all this, one would expect erosion of a substantial part of the money supply bulge in the weeks immediately ahead.

One way of attempting to look at the underlying recent trend of the money supply might be to compare the average of the four statement weeks ending March 25 with the average for the four such weeks ending December 24, thus eliminating both month-end bulges. This comparison still shows more than a 3 per cent annual rate of expansion. Alternatively, if recognition is given to the fact that these four weeks in December were low relative to November, comparison of an average for the 8 weeks ending December 24 with the four statement weeks ending March 25 would show a little over a 2 per cent annual rate of money supply growth.

One further point on this subject, if I may. In the first half of last year there was a downward bias in money supply growth stemming mainly from the large expansion of cash items associated with the rising volume of overnight Euro-dollar transactions engaged in by domestic banks through their foreign branches. The effect of this on the money supply was corrected as a result of last July's redefinition of deposits subject to Regulation D. The present source of money supply bias stems from the activities of Edge corporations and foreign agencies. This bias is understating the level of the money supply, but in the first quarter the rate of change in the series does not seem to have been greatly understated.

With respect to the bank credit and money supply paths laid out in the blue book, it would seem to me

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that, even with the current strengthened economic outlook, it would not be undesirable if, given moderate growth in money supply, bank credit expansion rose above the 4-1/2 per cent second-quarter annual rate shown for the first alternative. Somewhat greater bank credit growth might prove necessary to satisfy liquidity preferences of banks, to be consistent with savings inflows needed to accommodate liquidity rebuilding at other financial institutions, and at least to keep both short- and long-term interest rates from backing up further relative to their March lows--all developments that might be required to lead to recovery in the key mortgage and State and local government security markets.

Mr. Hersey made the following statement concerning international financial developments:

I would like to look at our balance of payments today from an angle somewhat different from the one Mr. Solomon took at the last meeting. You will recall that he developed four propositions about the bearing of balance of payments considerations on current monetary policy decisions: first, that monetary policy that was too tight for too long would not be good for the balance of payments, since a recession would be accompanied by an increase in net capital outflows and since a subsequent forced-draft recovery could bring revival of inflationary pressures; second, that the urgency of ending price inflation to protect the current account of the balance of payments plus the desirability of guarding against too massive a capital outflow are considerations arguing for caution with regard to permissible rates of expansion of the monetary aggregates; third, that the same considerations underline the desirability of avoiding later this year or in 1971 another burst of excess demand in the U.S. economy; and, finally, that with monetary policy moving away from severe restraint, the need to maintain regulatory restrictions on capital outflow is compelling. I have repeated these points today because I fully share Mr. Solomon's sense of their importance.

The particular angle from which I would now like to look at recent external developments is with regard to the effects of excess demand abroad on our balance of

payments and on our economy. During the past year the industrial economies of the rest of the world have been in a phase of expansion and boom comparable only with those of 1965 and--farther back--1956, and the end of the present boom is not yet in sight. In the forefront have been Germany, Japan, and Italy, three countries whose rapid economic growth over the past two decades has greatly increased their weight in the world economy. It is startling that in Germany, once thought to be a country immune to the inflation virus, wholesale prices for industrial products rose from last summer to February of this year at an annual rate of 9 per cent. In the course of 1969 there was a 13 per cent increase in average hourly earnings, substantially more than the average rate of 9 per cent from 1962 to 1966. In Japan, too, price advances in the past year have been unusually large. Italy has been going through a veritable wage explosion in the wake of last autumn's labor unrest. France is another country with strong inflationary pressures. Britain is the major case of a country not suffering from excess demand, and for the moment it is in a far better position with respect to its balance of payments than it has been for many years, but Britain is clearly entering now on a phase of rapid wage inflation which is bound to raise its aggregate demand and to push up prices.

All of these countries are trying to brake their expansion with tight monetary policies and, in varying degrees, with restrictive fiscal policies. But desires for higher living standards are all-pervasive, and faith in the will and ability of governments to prevent economic depression is strong. Many evidences can be found that the boom has farther to go. One crucial evidence, so far as the continental European economy is concerned, is that in Germany the backlog of unfilled orders for machinery and equipment is not only unprecedentedly large but has continued to grow in recent months.

The effects of excess demand abroad are visible in our exports. Despite the deterioration in our competitive position that was developing between 1965 and 1968, and despite the continuing rise in U.S. prices, our exports are doing reasonably well, as the February statistics show. Export orders for machinery and equipment have been strong.

Along with this welcome effect, we are also seeing the effects of inflation abroad on our own prices. In

world markets for metals, demand has clearly been out-running supply since about the end of 1967. European and Japanese demand in the aggregate has been very important in this regard, and increasingly so relative to ours in recent months. Advances in U.S. prices for steel and nonferrous metals, as well as for machinery, have therefore been in part reactions to world market conditions, not merely to U.S. market conditions. Moreover, the bullishness about price prospects that strength of world markets generates tends to enlarge both inventory investment demand and fixed capital investment demand everywhere. The U.S. economy has not been immune from such influences. Indeed, this may be one reason why our imports in recent months have been running above the forecasts.

Considerations of these kinds in no way modify Mr. Solomon's four propositions, but they may be a help in diagnosing the state of the U.S. economy. So long as the boom abroad persists, its effects will add to the difficulties the United States is having in halting price inflation.

Is there a silver lining? Will the price-raising pressures that are now being exerted in other countries serve to restore our competitive position in world trade in future years? The answer depends greatly on the further course of our own price and cost levels. Last year our prices of manufactures rose about like the average of others.

I will conclude with a brief note on the discussion of the U.S. economy which took place last week in the IMF Executive Board, winding up the Fund's latest periodic consultation with the United States. As William Dale, the U.S. Executive Director, has reported to us, there was general agreement in the Executive Board that a substantial improvement in the current account of our balance of payments is needed. Some Directors doubted whether fiscal policy is restrictive enough at present, and most Directors feared that a premature shift of policy toward expansion would be a more probable development than precipitation of an unwanted recession. According to Dale, "there was no dissent with the careful easing of monetary policy that was believed to have taken place, but the theme of remarks on this subject was that caution should continue to characterize monetary policy."

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Chairman Burns then called for general discussion of current and prospective economic and financial conditions.

In the course of the discussion it was noted that a decline expected in the average level of the money supply from May to June was related to an anticipated rise in Treasury balances, but that the former was thought likely to be only about one-third as large as the latter. Mr. Hickman observed that there were frequent short-run fluctuations in the money supply as presently defined because of changes in Treasury balances, and suggested that it might be useful to broaden the definition of money to include the latter. Chairman Burns commented that at the Board's request the staff was currently looking into a number of possible changes in the manner of calculating the money supply figures, including that mentioned by Mr. Hickman.

Mr. Hickman then noted that the staff had modified its assessment of the outlook since the February chart show. In particular, there had been a substantial change in the expected posture of fiscal policy; for example, the Federal deficit projected for the second quarter had been increased from an annual rate of \$6.7 billion as of February to \$11.2 billion now. The change in fiscal posture would not only have a direct effect in stimulating spending, but it would also contribute to inflationary psychology on the part of business and labor. While Mr. Partee had observed that the targets for money and bank credit growth shown under alternative B

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were more nearly consistent with the assumptions used in the February chart show than were those shown under A, he (Mr. Hickman) thought the Committee should reassess its earlier targets for the aggregates in light of the revisions in the GNP projections. He personally preferred the money and credit growth rates associated with alternative A.

Mr. Partee remarked that the question before the Committee, as he saw it, was whether the latest GNP projections portrayed a satisfactory situation. The projections implied real growth at only a 3 per cent rate in the second half of 1970, and a rise in the unemployment rate to 4.8 per cent in the fourth quarter; and they did not suggest that the economy would be overtaxed. He also noted that if the economy was stronger than had been suggested in the February chart show, growth of money and bank credit at the rates assumed at that time would mean that interest rates would be commensurately higher than projected then.

With respect to the general business outlook, Mr. Hayes said that the clear and present problem seemed to him to be much more one of inflation than of significant recession. He agreed with Mr. Partee's comment that a cumulative downward spiral was unlikely, and he thought there recently had been signs of improvement in a number of the major sectors of the economy. The inventory situation certainly had improved since the Committee last met, and the easing of interest rates that had occurred had laid the

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groundwork for betterment in the housing situation. Recent surveys continued to suggest strength in business capital spending, and he found it hard to believe that actual spending would fall significantly short of the reported plans.

In the area of fiscal policy, Mr. Hayes continued, he thought the outlook was now more stimulative than earlier, although he had felt all along that there would be greater stimulus from fiscal policy than the budget figures suggested. He was disturbed by the proposed pay raise for Federal workers and he was skeptical about the possibility that the increase in expenditures would be offset by higher taxes. It seemed to him that--with the reduction and then elimination of the surcharge, the increase in social security benefit payments, and now the Federal pay raise--there was a very good chance that the consumer sector would be a source of substantial economic stimulation. And he had some qualms about the termination of the holdback of Federal construction funds, not because of its direct economic effect--which might be small--but because it suggested a relaxation of the general posture of fiscal restraint to observers here and abroad. And the nation's balance of payments problem seemed to him to continue more or less intractable; there had not been much improvement in the balance on current account, which was the important area. Like other Committee members, he favored a modest acceleration of economic growth and,

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to that end, he would like to see moderate increases in the monetary and credit aggregates. But in light of various considerations he had cited, he thought it was quite possible that the actual increases in GNP would be more sizable than even the revised Board staff projections suggested. To his mind, the main risk was on the upside rather than the downside.

Chairman Burns said he would comment on the general economic situation later but might offer a factual statement on inventories at this point. When he had testified before the Senate Banking Committee on March 18 he had expressed optimism about the inventory situation, on the basis of the book-value data for January available then. Those data suggested that the adjustment was proceeding rapidly and might already have been accomplished in large part. They indicated that there had been disinvestment in aggregate inventories, reflecting a marked reduction in the rate of accumulation at manufacturers and wholesalers and a sharp absolute decline at retailers. While no later figures were as yet available for retail inventories, February data for the other sectors had now thrown a cloud over the picture. Specifically, in February there was an upsurge in the book value of inventories at manufacturers and an upturn at wholesalers as well. With those incomplete data for February in hand, the kind of optimism that the January figures had appeared to warrant no longer seemed justified.

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Mr. Francis remarked that, against the background of the monetary policy actions of 1969--which he thought in general were good--economic activity was presently at about the level that should have been expected and desired. Now that the Committee had moved to a posture of permitting some growth in the monetary aggregates, it should be able to ride through the slow cure of inflation without becoming involved in a deep recession. Some of the comments on fiscal policy this morning reminded him of the forecasts in mid-1968 suggesting that imposition of the tax surcharge would have a marked impact on the economy. He was not impressed with the possibility that recent changes in Federal expenditures would have as much impact on activity as some thought. He would still estimate that with an increase in the money stock at a moderate 3 per cent annual rate, total spending would grow at about a 4 per cent rate through the rest of 1970. Such a growth rate in demand would seem to be about right. It should mean that the rate of price advance would slow somewhat in 1970, and that the stage would be set for a further slowing in subsequent years. On the whole, he thought monetary policy was pretty much on target at the moment.

Mr. Coldwell said he had two principal comments. First, if the Board staff's projections were correct, the prospective rate of inflation was unacceptably high. Since the last meeting the staff had revised upward the increases in dollar GNP it was projecting for the third and fourth quarters of the year to the

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neighborhood of the increases experienced in 1969, and as the members would recall those advances had been a source of considerable concern to the Committee at the time. If the Committee's current policy was designed to permit such increases, that policy should be reconsidered.

Secondly, Mr. Coldwell continued, in recent conversations with businessmen and others in his District he had detected a considerable note of pessimism as a result of the changes apparently in prospect in Government spending and Federal pay scales. Those people who had predicted earlier that economic policy would not remain restrictive long enough to get inflation under control were now saying "I told you so."

Mr. Clay remarked that businessmen in his District had begun to believe that monetary policy was moving in the right direction and was taking hold, and that if the System persisted in its course there was some chance of controlling inflation. Perhaps they never quite understood how it would be possible to do so given the nature of labor demands and the rate at which costs were rising, but they did have some faith in the determination of the Federal Reserve. However, that faith would disappear rapidly if the Committee set its targets for growth in the monetary aggregates at too high a rate.

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Mr. Clay added that the man on the street still seemed to have an inflationary psychology. Although the ordinary citizen might have some sympathy for the demands of the postal workers and the air traffic controllers, he was persuaded that the Government's response was reflecting election year politics. He thought that costs and prices were now out of hand, and that the Government was not going to win the battle against inflation.

For such reasons, Mr. Clay observed, he thought the Committee had to be particularly careful about raising its sights for growth in the aggregates. What was needed was a gradual increase.

Mr. Swan referred to Mr. Partee's comment that the postal strike and Federal pay concessions might have intensified the problem of upward pressures on costs in the private area--a possibility which he understood was not allowed for in the revised GNP projections. He thought the recent developments in the Federal sector would have quite extensive consequences for the private sector. That, of course, raised the basic issue of the extent to which monetary policy could deal with inflationary pressures in an economy that was operating below capacity.

Mr. Swan then referred to the Manager's comments about the possible need to increase money market rates under certain circumstances and the market reactions that might be expected to such a move. He (Mr. Swan) thought the Committee had to accept the fact

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that its increased emphasis on aggregates for target purposes meant reduced emphasis on money market conditions. While he would not want System operations to give too big a wrench to expectations, he thought the Committee should be prepared to accept tightening-- as well as easing--of money market conditions if that was required to achieve the aggregate growth rates desired.

Finally, Mr. Swan said, he would agree in general with Mr. Axilrod's observations about the experience of savings and loan associations in February and the likely developments in March. California associations undoubtedly would show a net increase in savings balances in March, but probably by an amount not much greater than the interest credited. Flows in April would be affected by special circumstances--both property tax and State income tax payments were due in that month. It was quite possible that there would be some net outflow for the month as a whole, although perhaps not as substantial as last year.

Mr. Daane remarked that he agreed with much of what Messrs. Clay and Swan had said about the economic situation. While he did not think that Mr. Hayes' characterization of the existing situation as involving primarily a clear and present problem of inflation was entirely consistent with the contours of recent economic developments, he did agree that there was a clear danger of a resurgence of inflationary expectations and pressures. He shared Mr. Swan's view that recent

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wage developments in the public sector would have important consequences for the private sector. From his conversations with people in the financial markets he sensed that they expected a resurgence of inflation. However, he had not yet detected such a view in consumer attitudes as reflected in surveys, nor even necessarily in business attitudes as viewed from Washington. On the latter point, however, he would defer to the Reserve Bank Presidents, who were in a better position to judge the matter. An important question was whether a shift of expectations had begun in financial markets that would spread to the rest of the economy, and whether those expectations would be confirmed if the System did not resist the decline in short-term rates that the Manager had noted was likely.

Mr. Baughman said he could report that, among the major industries of the Seventh District, there had been indications of further weakening recently only in the electronics industry. There was some possibility that steel might show some evidence of weakening in the months ahead. By and large, however, the evidence seemed consistent with the implication of the staff's GNP projections that the economy was at about the bottom of its current adjustment.

In the automobile industry, Mr. Baughman continued, the analysts that the Chicago Bank had contacted seemed convinced that the corner had been turned and that production and sales would be moving up during the summer. According to preliminary plans, one

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of the three major automobile makers would be shutting down for the annual model changeover in late June and the others a few weeks later; and full production on the 1971 models would be under way by late August. That accelerated schedule had been adopted partly because, with wage negotiations coming up, the companies wanted to stock up their dealers with the new models before present labor contracts expired.

In a further comment, Mr. Baughman remarked that the Chicago Reserve Bank maintained a running tabulation of announcements of price changes that no doubt was unscientific but nevertheless had served as a fairly good indicator in recent years. In February there had been a significant decline in the number of announced increases relative to decreases, but the tabulation for March showed a strong advance in the number of increases. For that reason he was concerned about the possibility that the Committee might be taking too optimistic a view of the prospects for deceleration in the rate of inflation.

In reply to questions by Messrs. Eastburn and Daane, Mr. Holmes said he thought that, if declines in short-term interest rates were not unduly large, the market probably would interpret them as reflecting the normal seasonal pattern rather than a change in System policy. The long-term markets were subject to many influences; currently, investors were watching to see whether

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the volume of new offerings would remain at recent high levels. There was much concern about the possibility of a resurgence of inflationary pressures, but also a good deal of uncertainty. The concern would be reduced if the Federal pay increases were financed out of increased revenues, but market participants were skeptical about the willingness of Congress to follow that course.

Mr. Heflin expressed the view that there was not a great deal of difference between the economic outlook at present and at the time of the last meeting. It was still necessary to steer a narrow course between the dangers of a resurgence of inflationary pressures and of a deepening recession, although the latter danger might have been reduced somewhat.

Mr. Heflin said he thought the Reserve Bank Presidents should exercise care in interpreting such comments as they heard in their Districts to the effect that it would prove impossible to control inflation. The differences between what was said on that subject in the Districts and in Washington was significant; and if the Committee acted in a manner designed to allay fears of inflation it might invite actions by the Administration and Congress that would result in more rather than less inflationary pressure. There was a basic question of the Committee's responsibility for dealing with cost-push inflation. In his judgment monetary policy could not be expected to correct all past errors.

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At present, Mr. Heflin concluded, he was less concerned about the risks of a recession than those of an upthrust. However, he thought the Committee should not over-react to the possibility of a resurgence of inflationary pressures on the basis of one month's data.

Mr. Maisel remarked that there were grounds for the Committee to be concerned about the rate of increase the staff was now projecting for the GNP deflator in 1970. However, he had considered the staff's earlier projections with respect to price increases to be too optimistic, and their present projections were not worse than his own earlier expectations. Secondly, while he thought real GNP would rise as fast or faster in 1970 than the rates the staff was now projecting, he noted that those rates were still below the Administration's expectations and policy desires as set forth by the Council of Economic Advisers in January.

Mr. Brimmer remarked that in one important respect something had changed since the previous meeting of the Committee-- the staff was now projecting that the GNP deflator would increase 4.7 per cent in 1970, the same as it had in 1969. He might also note that there was nothing inherent in the legislative process to suggest that the stance of fiscal policy would be firmer than the Administration proposed; quite the contrary. However, his purpose was not to quarrel with the projections but to raise the question of whether an annual rate of inflation of 4.7 per cent for two

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years in a row was acceptable to the Committee. In his judgment it should not be.

Chairman Burns said he thought all members of the Committee would agree with Mr. Brimmer that the price outlook was distressing. But it was necessary for the Committee to face the question of what it could do about it and what it should try to do.

Mr. Morris expressed the view that the Committee did not yet have enough evidence to permit a clear view of the prospects for 1970 and, accordingly, it could easily make mistakes in either direction. Events of the past month had provided grounds for raising the GNP projections and for expecting fiscal policy to be much more stimulative. Nevertheless, there still were grounds for believing that the projections might err on the high side. In particular, much of the growth of GNP projected for the second and third quarters reflected an anticipated acceleration of the rise in personal consumption expenditures. It was clear that there would be new injections to the income stream, but it was quite possible that the saving rate would be substantially higher than the staff had projected. Various kinds of evidence, including recent consumer surveys, lent support to that possibility. He would expect the economic outlook to be considerably clearer at the time of the Committee's next meeting.

Mr. Galusha remarked that to him the most impressive thing about recent events was that they contained so few surprises.

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Although the postal workers' strike had had an emotional impact, that should not have been the case with the other strikes, since it had been clear for some time that a period of labor unrest lay ahead. Like others, he was disturbed by the upward revisions in the projections of price increases, and it might well be that the Committee had been counting too heavily on unused capacity to hold down the rate of inflation. On the other hand, the unemployment rate was rising and it was clear that the effect of monetary restraint was still being felt. There also was the evidence of the survey of manufacturers' expectations that his Bank conducted periodically. In the last three surveys, manufacturers had progressively revised downward their expectations for sales over the coming three quarters.

Mr. Galusha noted that the Committee was now formulating its objectives on a longer-run basis than previously. He had the impression from the discussion thus far that some members felt that the Committee should be shifting its longer-run goal at this time. Perhaps the situation might look different in a month from now, but at present he concurred in Mr. Partee's view that there was little basis for changing the Committee's policy of encouraging growth in the aggregates at about the rates suggested in the February chart show. Like Mr. Francis--if for different reasons--he was sensitive to the lessons of 1968, and he would not favor taking precipitous action to change policy at this time.

Mr. Robertson said he did not think any members favored shifting the Committee's longer-run objectives at this time.

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Nevertheless, he was much more fearful today of resurgence of inflation and inflationary psychology than he was of recession. He thought the whole business picture had changed recently--for one reason, because of the way the Government had given in to the demands of postal workers and was proposing to pass the costs on to consumers in the form of price increases. He thought that would have important implications for the way in which businesses reacted to wage demands.

Mr. Robertson added that if there were a resurgence of inflation it probably would prove impossible to cope with it through general stabilization policies, and direct controls would be required. That would be most unfortunate. He was not recommending a stop-go monetary policy, but did urge that the Committee take note of the danger signs that had been raised and make sure it was not moving too fast.

In reply to a question by Mr. Galusha, Mr. Robertson said he was not proposing operations designed to signal financial markets that the Committee would not tolerate rapid declines in interest rates or rapid growth in bank credit. Rather, he was urging that the Committee proceed with great caution, taking pains not to validate inflationary expectations. To do otherwise would be to widen the credibility gap on stabilization policy. The need for caution was also suggested by the comments of bankers with whom he had talked recently to the effect that their loan demands were

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as strong today as ever. If the time deposits flowing into banks were used to meet those demands, a resurgence of inflationary pressures was highly likely.

Mr. Kimbrel said he would like to associate himself strongly with Mr. Robertson's views. Businessmen and bankers with whom he had talked in the last three or four weeks believed that economic restraint would be of very short duration and that the economy was once again heading into an inflationary spiral. Their increasing pessimism was demonstrated by the fact that they were becoming more and more willing to consider the possibility of wage and price controls.

Chairman Burns said he agreed with the statement made earlier that there was a clear and present problem of inflation. However, he thought it had not been said with sufficient vigor that there also was a clear and present problem of recession. Speaking first of the inflationary problem, in his judgment the situation had changed since the last meeting of the Committee. There had been an insurrection against the Government, and the Government had dealt with it in a manner that resulted in a very sharp increase in the pay of Government employees. Within a twelve-month period the pay of postal workers would rise by 14 to 16 per cent and that of the civil servants by something close to 12 per cent. Many people had been hoping that the Government would set an

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example of moderation for private industry and the President had sought to do so in his Budget Message. It now appeared, however, that the Government might be leading the wage parade.

That was a highly unfortunate development, the Chairman continued. What were its implications for the economy? On the budget side, he had very little concern. The President had strongly indicated that the additional cost should be met--and that he expected it would be met--through additional revenue. Of course, his recommendations might not be entirely accepted by the Congress. Even so, the quantitative change in the fiscal picture would be quite small. But while he (Chairman Burns) was not distressed by the budgetary change, he was distressed by the fact that the Government had set an example of pushing up wages and had lost its strong moral position in the effort to keep wages under restraint.

Chairman Burns suggested that certain fundamentals should be kept clearly in mind in assessing the implications of recent events for monetary policy. In particular, excess demands had been largely eliminated from the economy, and the inflation that was occurring--and that was now being accentuated, how far he could not say--was of the cost-push variety. That type of inflation, he believed, could not be dealt with successfully from the monetary side and it would be a great mistake to try to do so. One had

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either to live with it or to begin thinking along the lines Mr. Robertson had mentioned.

The Chairman then remarked that he would also say a word about the clear and present problem of recession. During the past three months the unemployment rate had increased from 3.5 per cent to the successively higher levels of 3.9, 4.2, and 4.4 per cent. That was a rapid increase--and it was a matter of hard statistics, not projections. Whatever the shortcomings of those figures, their showing was confirmed by data on industrial production and retail sales. Retail trade in March evidently had been no higher than in February, and in February it had been only 0.6 per cent above the year-earlier level despite a 6 per cent rise in the consumer price index. A recessive process was under way in the economy, and if one examined the data systematically he was likely to reach the conclusion that the current decline was larger than those of both 1966-67 and 1960-61.

The Chairman said it was often difficult to draw firm conclusions about the posture of fiscal policy because there were several possible ways of viewing it. However, the economics profession had come increasingly to look upon the theoretical construct of the "full employment surplus" as the best indicator of whether--and to what degree--the Federal budget was stimulative or restrictive. The reason for that preference was clear: the

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deficits that developed in recessions reflected the effect of the economy on the budget. When one spoke of changes in fiscal policy he normally had in mind changes reflecting deliberate actions of the Government rather than cyclical developments in the economy.

Chairman Burns said he had recently examined carefully various estimates of the full employment surplus, including those made by the staffs of the Board and the Federal Reserve Bank of St. Louis, by the Brookings Institution, and--on a less formal basis--by Walter Heller. As a group, those estimates indicated that in the first half of 1970 the budget was moving toward stimulus. However, the budget would become more restrictive in the second half of 1970, and it would become very restrictive in the first half of 1971. He had had those estimates recalculated to take the proposed Federal pay raises into account; while the figures changed, the general picture remained the same. Accordingly, statements that fiscal stimulus was increasing, such as some members had made today, appeared to be accurate for the first half of 1970 but not later on. In addition, statements to the effect that fiscal policy was overstimulative presumably were based on estimates not of the full employment surplus but of the actual budget position.

In sum, Chairman Burns said, he thought there were clear and present problems of both inflation and recession. Those

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problems were being interpreted in one way by business and financial people, particularly those in the great money centers; quite differently by the great mass of the public; and certainly quite differently by Congress. There was a piece of legislation before Congress now which had grown out of judgments that there was a clear and present problem of recession in the economy and of depression in the housing industry--and that Congress had to do something about the latter. He was referring to the omnibus housing bill containing the Proxmire amendment. In all likelihood the bill would be enacted, and unless the Proxmire amendment were dropped or modified it would be only a matter of time before the Federal Reserve would find itself in the position of some Latin American central banks. He had been urging an alternative to the Proxmire amendment which would provide for the expenditure of some additional Federal money but would not affect the status of the Federal Reserve System.

Chairman Burns then called for the go-around of comments and views on monetary policy, beginning with Mr. Hayes.

Mr. Hayes said he still believed that the danger of inflation was considerably greater than that of recession. He was reluctant to engage in debate over the appropriate means of measuring the stance of fiscal policy, but he would note that according to a measure calculated at his Bank fiscal policy would be definitely stimulative in both fiscal 1970 and 1971.

Mr. Hayes then continued with the following statement:

The Committee's desire to see moderate growth in the money and bank credit aggregates is a proper intermediate policy objective. It would appear to be consistent with a reduction in price pressures and with a moderate strengthening in the economy over the rest of the year--these being the ultimate objectives of policy. I would interpret moderate growth as a rise in the money supply at an approximately 3 per cent annual rate, recognizing that this would certainly entail considerable variation from month to month, and certainly from week to week.

I am a little disturbed by the blue book implication that even a small change in the desired growth rates of the monetary and credit aggregates should require a change in the directive. A growth rate of anywhere from 2-1/2 per cent to 3-1/2 per cent for the money supply over the second quarter appears consistent with the 3 per cent rate we were looking for at the last meeting. It is much more difficult, given the uncertainties over the extent of reintermediation, to specify a growth rate for bank credit. But I would consider a bank credit growth rate of anywhere from 4 per cent to 8 per cent as moderate. Thus, I would be content with growth rates for the aggregates in a range embracing those associated with both alternative A and alternative B for the directive.

In moving over to a directive framed primarily in terms of monetary aggregates, we should be careful to guard against excessive variations in money market conditions that might result in interest rate changes that would not be justified by the underlying state of the economy and might only lead to unwarranted changes in market expectations. I therefore suggest that, in instructing the Manager to achieve moderate growth in the monetary aggregates, we also set some rough limits on the extent to which money market conditions might vary during the period until our next meetings--even if not explicitly stated in the directive.

The objectives with respect to monetary and credit aggregates seem to be consistent with a set of money market conditions roughly in line with what we have experienced in recent weeks, including a weekly average Federal funds rate in the 7-1/2 to 8 per cent range. I think the Manager should have considerable

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discretion with respect to future variations in money market conditions. But I would be disturbed if the average Federal funds rate were much outside of a 7 to 8-1/2 per cent range, particularly in the light of the Treasury refunding.

With these interpretations, I prefer the wording of alternative A of the directive.

Mr. Francis said that, as he had indicated earlier, he would not be unduly concerned about rapid growth in bank credit as a result of continuing reintermediation, and he would want to focus on the money stock. He thought a continuation of growth in money at an annual rate in the neighborhood of 3 per cent, such as had prevailed recently, would be appropriate, and he would not want to see significant acceleration in the growth rate. He found it difficult to express a preference between the two alternatives for the directive because he was not sure what the differences were in their implications for aggregate demands. However, the Committee might want to consider deleting the proposed reference to the Treasury financing and call for operations to be conducted as if no financing was in prospect.

Mr. Kimbrel observed that there had apparently been a change in the tone of business sentiment since the Committee's last meeting which, he thought, emphasized the danger of easing policy too much. Annual growth rates for the second quarter of 2-1/2 per cent in the money stock and 4-1/2 per cent in the credit proxy, as specified in the blue book under alternative A, did not

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appear to him to be excessively easy. But if the growth rate in bank credit exceeded the target because of a greater-than-anticipated inflow of time deposits, he would regard the over-all posture of policy as easier than appropriate. In such a situation a reduction in the rate of growth in the money supply would seem desirable. If he had a choice he would prefer alternative A for the directive, subject to that qualification.

Mr. Eastburn said that he would favor alternative A since it seemed more likely than B to be consistent with the objectives of fostering moderate growth in the aggregates without encouraging a resumption of inflationary psychology. He would be concerned that alternative B might result in a drop in Treasury bill rates of greater than seasonal dimensions, and that that might be interpreted by the market as a signal of a further easing in monetary policy. The Committee might want to consider adding a proviso clause to the directive regarding acceptable ranges of fluctuation in money market conditions. He would not press the matter, however, since the Manager no doubt was aware of the importance of avoiding an undue easing of money market conditions.

Mr. Hickman said he favored alternative A. He thought that the recent shift had put policy on the right path and that the present stance should be continued. While a recession was still a possibility, the latest evidence in the Fourth District and

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elsewhere suggested that the dangers of a cumulative downturn had lessened--hopefully in part because of the actions the Committee had taken at recent meetings. There also had been some increase in inflationary psychology, partly as a result of the Government's decision to increase the pay of Federal employees and the expectation that Congress would prove unwilling to finance the pay hike.

For those reasons, Mr. Hickman remarked, he preferred the targets for the aggregates under alternative A to those under B, and he would be more concerned about upward deviations from the targets than about shortfalls. He would be prepared to let market interest rates find their own levels, and he agreed with Mr. Francis that not much weight should be given to even keel considerations at this time. The main objective should be to foster moderate but not excessive growth in bank credit and the money supply.

Mr. Sherrill commented that he was impressed with the degree of change that had occurred since the Committee's last meeting. In his judgment the major risk had shifted back to one of inflation. The rate of price advance now projected for 1970--4.7 per cent--struck him as unacceptably high; if prices actually rose that much during the year the decision might well be made to impose direct controls. Although there were limits to what monetary policy could do in slowing the rate of price advance, he thought that long-range objective would be best served by aiming for the 2-1/2 per cent growth rate in money in the second quarter associated with alternative A.

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In the short run, Mr. Sherrill continued, it was important that the System's actions not contribute to inflationary expectations by affecting banker psychology and encouraging large increases in bank lending. For that reason, he thought attention should also be given to the bank credit proxy. An 8 per cent annual rate of growth in the proxy series seemed to him about the maximum that should be permitted, and he would lower the target for the money stock if growth in the proxy were exceeding that rate. Conversely, he would accept an increase in the money stock at a rate as high as 3-1/2 per cent if the credit proxy turned out to be weak. With those guidelines in mind, he would favor alternative A for the directive.

Mr. Brimmer said that the change in the fiscal situation, however measured; the change in expectations, however arrived at; and the prospective wage increases in both public and private sectors all suggested that there would be more inflation this year than had been anticipated. He thought the public was watching closely to see how the Federal Reserve would react to the latest developments. He hoped the System would make it clear that it did not view the trend of events with approval and that its operations would be designed to disappoint rather than to validate the expectations that had been engendered. He favored alternative A for the directive, and he would want any tendency for growth in the

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aggregates to drift toward the rates associated with alternative B to be resisted.

Mr. Maisel said that for second-quarter targets he favored the aggregative growth rates associated with alternative B--3-1/2 per cent for the money stock and 6-1/2 per cent for the bank credit proxy. In his judgment, however, those growth rates were more likely to be achieved under the operating approach associated with alternative A in the blue book. Accordingly, he would favor instructing the Manager to aim for the B targets by currently moving in accordance with the conditions shown under A.

Mr. Daane expressed the view that it would be appropriate in the current economic situation to encourage moderate growth in the monetary aggregates. However, because he shared Mr. Robertson's concern about possible future developments, he thought the Committee should be careful to avoid any actions that would contribute to a resurgence of inflationary expectations in financial markets or to the spill-over of such expectations into the business sector. On an issue the Manager had raised earlier, he would favor allowing short-term rates to fall so long as the market regarded the declines as seasonal, but he would want the declines resisted if the market began to view them as a signal of a further easing of policy.

As far as the specific targets for the aggregates were concerned, Mr. Daane continued, he favored those associated with

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alternative A and would not want the Manager to actively seek those given under B. But he did not think the difference between the two sets of targets was highly significant and he would not be disturbed if the results were closer to those under B.

Mr. Mitchell remarked that he too favored alternative A for the directive. In fact, he was surprised that the staff had felt it necessary to present alternative choices. Like others, he had been made somewhat uneasy by recent developments. However, he thought that **psychology** should be expected to fluctuate in the short run; he would not go as far as some economists in denying the significance of changes in expectations, but he did think it was easy to attach too much weight to them. He therefore thought the Committee should hold to its present course. He favored a target for the money supply about half-way between those associated with alternatives A and B, although the difference between the two did not appear large enough to be very meaningful operationally.

Mr. Mitchell went on to say that if he were greatly concerned about the risks of a recession he would be advocating actions designed to have an immediate effect on mortgage lending commitments and investments in State and local securities. But he was not sufficiently concerned about that risk to want to see the sort of easing of rates that would be needed for that purpose.

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However, as he had indicated at the previous meeting, he did favor a further increase in Regulation Q ceilings on large-denomination CD's. Such an action, the main effects of which would not be felt for several months, might be that which was best suited to deal with the recessionary tendencies in the economy. He would not be concerned if the bank credit proxy rose at an annual rate of, say, 12 per cent following action to increase the Q ceilings.

Mr. Mitchell remarked that he was disturbed by the Chairman's earlier comment to the effect that monetary policy could not do anything about cost-push inflation. He thought it could slow such inflation by creating and maintaining a climate of slow growth, low corporate profits, and underemployment of resources.

In concluding, Mr. Mitchell said he would not be concerned by fluctuations in interest rates. He would not want to see too rapid an increase in the money stock, but would not be disturbed by rapid growth in bank credit.

Mr. Heflin observed that nothing in the latest information suggested to him that the Committee should depart from the general policy course it had set in its last two meetings. He continued to feel that the safest and surest way to negotiate the narrow channel between the opposing risks of inflation and recession was to work for a moderate growth--at an annual rate of, say, 2 to 4 per cent--

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in the money supply over the current quarter. But in view of the recent fiscal developments and unexpected strength in some key business indicators, he would feel somewhat more comfortable with a rate closer to the low rather than to the high end of that range. He would favor alternative A for the directive.

Mr. Clay said that in his judgment moderate growth in the aggregates should be conducive to an orderly transition to a balanced economy, and he would favor taking such growth as the target. The specific growth rates given in the blue book under alternative A might be taken as the bullseye of the target, but he would not necessarily expect the bullseye to be hit. As he had indicated earlier, he was a little afraid that the Committee might set its sights for the aggregates too high, perhaps because of concern about further increases in unemployment, and that it might fail to pay sufficient attention to the many obstacles that had arisen in the path toward achieving a gradual slowing of the rate of price increase.

Mr. Baughman commented that the policy adopted at the last meeting still seemed appropriate to him, and he therefore favored alternative A for the directive today. He was somewhat concerned about the fact that, according to the blue book figures, a large part of the growth in time deposits and the credit proxy, and to a lesser extent the money supply, that was targeted for the second quarter was expected to occur in April. He thought there was some

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risk that, if the indicated growth was permitted in April, expansion would not slow enough later to achieve the target growth rates for the quarter as a whole. In any case, he would be more concerned about rapid expansion in the money stock than in bank credit, and accordingly he thought a good deal more weight should be given to the money stock than to the credit proxy in the conduct of open market operations. The manner in which the Manager had proposed to proceed in pursuing the targets for the aggregates seemed to him to be appropriate.

Mr. Galusha said that in general he concurred in the views expressed by Mr. Daane. He was somewhat concerned, however, about the possible consequences of resistance to seasonal declines in short-term interest rates--of the sort the blue book noted might be required if bank credit growth was to be kept to the rate called for under alternative A. In particular, he was disturbed by the statement in the blue book that exerting upward pressures on money market rates for that purpose might lead to a back-up in interest rates on a broader scale.

Mr. Swan observed that he shared Mr. Morris' views about the uncertainties of the moment. While Committee members might or might not be over-reacting to recent events, however, it was quite clear that those events had not created a need for growth in the aggregates at a more rapid rate than sought at the preceding meeting.

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as called for by alternative B of the directive drafts. Accordingly, he favored the language of alternative A. He thought, however, that that language was consistent with a range of growth rates for the aggregates that encompassed those associated with both A and B in the blue book. Like some previous speakers, he leaned toward the alternative A targets but would not be disturbed if the actual growth rates were closer to those under B.

Mr. Swan added that he hoped it would not be necessary for the Desk to resist a seasonal decline in interest rates. If that did prove necessary, however, he would not be overly concerned about the risk of creating a reversal in market expectations. In his judgment it would take much more positive action to produce such an effect.

Mr. Coldwell said he was quite concerned about the danger of validating expectations of further inflation and of steadily easing monetary policy. He agreed with Mr. Brimmer on the importance of disappointing such expectations, and thought that could be best accomplished by stabilizing money market conditions. He would not be greatly disturbed if in the process growth in the aggregates exceeded the blue book targets. For those reasons he would prefer to have the directive reformulated to call for maintenance of stable money market conditions while seeking modest growth in the aggregates.

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Mr. Morris said he would have favored alternative B for the directive today if the recessive tendencies in the economy appeared to be gathering force. However, the surprising strength of the most recent data had raised enough doubts about the outlook to lead him to prefer alternative A for the present. He would urge the Manager to focus on the money stock; growth in the credit proxy at a rate above the target for alternative A--which he thought was probable--would not disturb him, and efforts to resist such growth would be likely to result in undershooting the money supply target.

Mr. Robertson said he would submit for inclusion in the record the statement he had prepared, and make only two comments. First, the aggregate growth rates associated with alternative A in the blue book represented the upper limits of the range he would consider acceptable at this time. Secondly, he would not want the Manager to pay much attention to changes in market interest rates unless they were outside the range of reasonable expectations, allowing for normal seasonal patterns.

Mr. Robertson's prepared statement read as follows:

It seems to me that the business and financial situation is developing in a way that should make us very cautious in what we do.

Clearly, real demands have slackened. But production cutbacks and inventory curtailments seem now to have proceeded faster than we thought before. As a consequence, we may be further through the process

of adjustment than we had projected. That opens the possibility for an earlier and more rapid business recovery than expected heretofore. And new fuel for that recovery is in prospect from the demand-pull and cost-push implications of the pattern-setting wage and salary increases being developed for postal employees and other Federal employees-- i.e., a strengthening of the tendency to give in to demands for wage increases and push the cost off onto the consumer through higher prices.

Awareness of these altered economic prospects is spreading throughout the business community. Coming as they do before the slowdown has produced any solid results in stabilizing prices, they increase the chances that inflationary psychology will strengthen once again. If it does, our practical ability to deal with it effectively through the general tools of economic stabilization is slim indeed, and we may be obliged to turn to direct controls, distasteful though that may be.

Therefore, it behooves us to be extremely careful in our policy actions during this interval. Neither we nor the Administration can afford to reopen a yawning credibility gap between our professed intentions to foster noninflationary economic growth and the public's candid appraisal of what we are doing.

In the light of the foregoing comments, monetary policy faces a very delicate test. I do not want to call for a reversal of our recent policy moves, because they are helping to provide some alleviation of the harshest effects of the preceding interval of unusually "tight money". But we need to watch very carefully to be sure that a continuation of our course does not go beyond the minimum alleviation needed and spur a sense of eased credit availability that fans inflationary expectations.

A case in point is the current reflow of funds to banks that our policy is fostering. As long as these funds are used preponderantly to rebuild strained liquidity positions to reasonable levels, I regard them as acceptable. If, however, they should begin to trigger a significant easing of lending policies, I think we have to be prepared to reconsider our posture-- even, if necessary, facing up to the need for shutting

off the flow of so-called non-deposit funds to banks and perhaps, in time, reducing "Q" rates on large-denomination CD's. The bankers I have talked to recently tell me their loan demand is as strong as it has ever been; if they should start to accommodate it, we would reap a greater addition to credit-financed spending than our economy could absorb.

Whatever else we do, therefore, we need to guard against such a break-out. To put the issue into simplest terms, growth in money and time deposits that permits an orderly restructuring of liabilities is acceptable; but growth that goes so far as to finance a new surge of spending is not. The precise numbers that accord with this policy objective are a matter of judgment, but I myself believe the blue book specifications associated with alternative A of the directive are indicative of the limits beyond which I think we should not go between now and the next meeting of the Committee.

Chairman Burns said he preferred alternative A for the directive for two reasons. First, he thought it was undesirable in general for the Committee to shift its policy stance from month to month on the basis of the latest readings of uncertain indicators. Secondly, in light of the recent disturbing developments on the wage front, he thought a call for "more growth" in the aggregates, as in alternative B, could have an adverse psychological effect.

While he thus preferred the language of alternative A, the Chairman continued, he had noted that the targets under the two alternatives were virtually identical for April and quite close for the second quarter as a whole. There was a fair amount of variation among the preferences for target growth rates that the

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members had expressed in the go-around today, but a number had indicated that they were thinking in terms of ranges that included both sets of targets given in the blue book. He would suggest that the Committee vote on the language of alternative A, with an understanding that the targets for the aggregates were intermediate to those associated with alternatives A and B.

Mr. Daane remarked that he planned to vote favorably on the proposal, on the assumption that the Manager would not be held responsible for hitting the targets precisely.

Mr. Brimmer said he agreed that the differences between the two sets of targets were small, but they were not negligible. He asked for a staff judgment as to whether the range around targets intermediate to those under A and B would normally be taken to encompass those associated with A.

Mr. Axilrod replied affirmatively.

Messrs. Hickman and Robertson said that they would also vote favorably on the Chairman's proposal, although they hoped that the actual growth rates in the aggregates would be nearer to the targets associated with alternative A. Mr. Robertson added he would be happiest if growth did not exceed the alternative A targets.

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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 economic policy directive:

The information reviewed at this meeting suggests that real economic activity weakened further in early 1970, while prices and costs continued to rise at a rapid pace. Fiscal stimulus, of dimensions that are still uncertain, will strengthen income expansion in the near term. Most long-term interest rates backed up during much of March under the pressure of heavy demands for funds, but then turned down in response to indications of some relaxation of monetary policy and to the reduction in the prime lending rate of banks. Short-term rates declined further on balance in recent weeks, contributing to the ability of banks and other thrift institutions to attract time and savings funds. Both bank credit and the money supply rose on average in March; over the first quarter as a whole bank credit was about unchanged on balance and the money supply increased somewhat. The U.S. foreign trade surplus increased in February, but the over-all balance of payments appears to have been in considerable deficit during the first quarter. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, the Committee desires to see moderate growth in money and bank credit over the months ahead. System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining money market conditions consistent with that objective, taking account of the forthcoming Treasury financing.

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The meeting then recessed and reconvened at 2:15 p.m. with the same attendance as at the morning session except that Mr. Pierce, Chief, Special Studies Section, and Mr. Poole, Economist, Division of Research and Statistics, Board of Governors, joined the meeting.

Chairman Burns noted that the Committee had planned to discuss next the report of the committee on the directive, dated March 2, 1970. He invited Mr. Maisel, who had served as Chairman of the directive committee,^{1/} to lead off the discussion.

In introductory remarks Mr. Maisel commented that the policy actions of the Open Market Committee at recent meetings had taken it a long way toward the procedures recommended by the committee on the directive. In his judgment, however, it was still rather important that the Open Market Committee reach explicit agreement on the nature and extent of the changes being adopted, for purposes of its own operations and to be better able to fulfill its responsibility to inform the public regarding the changes. He assumed that the Open Market Committee would make decisions about the general form of the directive and the roles to be played by the blue book and the green book. The staff might then be asked to draft a statement announcing

^{1/} Other members of the committee on the directive were Messrs. Morris and Swan. A copy of their report has been placed in the Committee's files.

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the changes, which could be published in the Federal Reserve Bulletin, as a press release, or in some other form.

Mr. Maisel then presented substantially the following statement:

You have all had a chance to go over the report of our committee, its appendices, and the 10 or 12 staff studies that formed part of the background of our report.

I think the most important point to stress is that our committee was unanimous in its recommendation. The staff was also unanimous in their agreement on the major difficulties with our current directive and the desirability for the Committee to move to a target based on monetary aggregates. There was no polling of the staff on the particular form of the directive which our committee selected.

1. Our committee found constant progress in the data available for policy formulation, in the content of the directive as an instruction to the Manager, in the Manager's adherence to the directive, and in his explanation of operations.

2. We also found, however, several problem areas. The major ones were the following:

a. Too little time of the Federal Open Market Committee has been spent in analysis and formulation of monetary policy for longer-run periods, stretching from the next Committee meeting until the time when monetary policy succeeds in altering demands for goods and services in the economy.

b. The FOMC has not specified well, or completely, the monetary policy it is trying to achieve nor the relationship between its instructions to the Manager and its desires.

c. The specification of operating targets in terms of money market conditions--primarily net borrowed reserves and the Federal funds rate--has often led to inappropriate policy, particularly in periods of rapidly shifting demands for credit.

A money market target means that the System is basically accommodative with respect to total reserves and deposits. The System sets the day-to-day rate for marginal bank funds. As experience shows, only gradually and over many months does the System react to the amount of money and credit the banks create at those rates.

The form of the directive weakens the System's control of money, credit, and interest rates. On too many occasions, and for too extended a period of time, the amount of money and credit has grown at a rate far greater or far smaller than would have been desirable in the economic circumstances. In retrospect, the volume of bank reserves, bank credit, and money supplied through monetary policy has too often been dominated by market expectations, by speculation, and by undue accommodation to excessively strong or excessively weak credit demands stemming from unwanted movements in the economy.

3. To improve the decision-making process and avoid past dangers, our committee makes three recommendations.

a. The FOMC should increase consideration of possible alternative monetary policies, their relationships to the Committee's goals, and longer-run strategies for attaining these goals.

b. The FOMC should reach agreement in qualitative terms on whether it wants monetary policy to be neutral, or to take steps that add to, or subtract from, demands for goods and services. Members of the Committee should indicate in specific terms the type of money and credit conditions they believe would be consistent with the agreed-upon policy. Members might specify the conditions they desired in any one measure, or complex of measures, they believed proper, such as the money supply, different types of credit, interest rates, expectations, etc.

c. The actual directive to the Manager of the Open Market Account would specify desired changes in total reserves for the next three months that are consistent with the consensus of the FOMC's views about desired financial conditions. This would include a total reserves path over the coming

four weeks prior to the next FOMC meeting. The Manager would then operate so that either the level of total reserves in the week prior to the next FOMC meeting agreed with the Committee's directive or so that there were logical explanations for the difference between the level achieved and the directive.

The reason for giving the Manager a four-week path is to provide a pattern that would avoid severely wrenching the money market in an effort to get back on target in the last week available before the next FOMC meeting. At each succeeding meeting, the FOMC would reaffirm or change the expected path and add an additional four weeks.

A major reason for selecting as a target total reserves in contrast to M_1 , bank credit, money market conditions, or any other variable should be made clear. Our committee recognized that at least for some time it would be difficult for the members of the FOMC to agree on a specific theory of monetary policy, on the relevant variables, or on the relationship between possible variables and desired results. However, such agreements, while desirable, are not necessary.

In contrast, the FOMC must instruct the Manager as to what changes are desired in the System's holdings of assets and of total reserves. As a result, whether explicitly or implicitly, each member of the FOMC must be specifying what assets or range of assets the Manager should seek or accept. Thus, the FOMC must be able to agree on desired reserve movements, even if it is fragmented in its individual views as to how such operations are expected to influence monetary policy and how such policy will influence the economy.

4. We are not suggesting that reserves would necessarily follow the particular three-month path agreed on at a meeting. At each future meeting, the FOMC would again select a path for total reserves. The new path would reflect the actual operations during the period, changes in the economy, the fact that the relationships between total reserves and other monetary variables were not developing as expected or desired, and similar pieces of information.

Similarly, the four-week path of total reserves in the interval between FOMC meetings might not necessarily coincide with that adopted at the previous meeting. The Manager would be expected to use his best judgment in fulfilling the Committee's directive. Alterations would occur either for technical reasons, because of Committee provisos, or because in the Manager's judgment the path he chose would lead to the Committee's three-month target more feasibly than the path set out in the previous meeting.

Thus, we would expect that at any meeting, the Manager would report that last week the level of reserves differed from the target by X billion dollars. This amount could roughly be accounted for by Y million arising from any or all of the following reasons, plus others not yet recognized.

a. The Manager had decided to furnish Y additional reserves, because he believed this would be a more logical method of achieving the Committee's three-month target. Irregular forces, errors in seasonals, etc., required more temporary reserves than had been expected.

b. The Committee's provisos required that he add or subtract reserves.

c. Operating errors occurred in the last week. Misses on float, balances, etc., meant that at the end of operations a discrepancy existed between projections and actual.

d. The Manager believed that the relationship of reserves to deposits or the money supply was varying from the projected. Banks were altering their excess reserve ratios, or there were unexpected shifts among deposits with different reserve ratios. Or the Manager had to give some weight to whatever sense of priority the Committee gave him in cases when various monetary and financial variables moved in disparate and unexpected directions.

This analysis of the Manager's would be a significant input for the formulation of the path in the next directive.

5. How would the proposed directives differ from previous ones with respect to operations?

a. For most of the past four years, instructions to the Manager have been couched in terms of money market conditions with a weak bank credit proxy proviso. The proxy was projected one month ahead

with a range from an expected annual growth rate of minus 12 per cent (August 1969) to plus 18 per cent (August 1968). There was little indication of how such an expected change related to any longer period or to monetary policy. In the periods when the proviso was activated, the most the Manager did was to move the funds rate slightly from prior targets. In contrast, frequent operations were engaged in primarily to avoid an appearance of any change in Committee decisions rather than to affect reserves.

b. Since January the directive has been altered somewhat. The Manager's target remains money market conditions, but the Committee has stated explicitly that it was attempting to achieve a modest and then moderate growth in money and bank credit. The staff has included a projection for these aggregates three months in the future.

The Committee has not instructed the Manager as to the meaning of modest or moderate, nor as to what weight to apply to differing movements between the two aggregates. The Manager has had to interpret the Committee's intent. He has also had to determine how far to change money market conditions when the projections appeared to differ from the Committee's intent. The Committee has not discussed the expected impact of any given changes in money market conditions nor the speed or maximum alteration the Manager is expected to make.

c. Under the proposed system, the Committee would specify the meaning of "modest," "moderate," or other growth or contraction. The FOMC would specify the change in total reserves believed compatible with its desires. The Manager would still have to use judgment as to how best to achieve the given target, and he could vary from the target between meetings if in his judgment he would more accurately be achieving the Committee's desires. However, at the next meeting, the Committee would have to ratify his judgment by revising its path or by instructing him to move back toward the initial targets.

d. There perhaps might be wider fluctuations

in the Federal funds rate. The degree of increased variance would depend in the first place on how successful the market was in adjusting to the new methods of operations and in using its own resources instead of depending upon the Desk.

In addition, of course, the degree of variance would depend upon the instructions of the Committee to the Manager in the form of a proviso clause.

e. The most significant difference would be that both the Committee and the Manager would have firmer targets. Operations would remain subject to operating problems, Committee provisos, and the Manager's judgment. The conditions which obtained in the market would be those compatible with reaching the desired target. The Manager would no longer have to operate primarily to avoid incorrect conclusions being drawn from his operations. He would not have to fear triggering an undesired reaction. Moreover, he would not be forced to attempt to pick money market conditions which he hoped would bring about the desired growth of reserves.

f. Under the new system, the Manager would have a total reserves target. He would set borrowings or excess reserves and marginal money rates in accordance with the amount that total reserves differed from the target. As a result he would react more rapidly to variations of bank action from that desired by the System. He also would allow larger movements in borrowings and in money market rates. The amount of change in these variables would be directly related to the amount by which total reserves were differing from the target. As a result the greater the difference between actual and desired, the greater the pressure on the banks to move toward the target. Under the present system there is a considerable lag in the Desk's movements in money market conditions depending on the next meeting of the Committee, and on whether announcement effects are feared. He may move conditions based on the proviso but only slightly. There is no relationship, at the present, between the amount the Desk changes its target and the excess growth or shortfall in total reserves or deposits.

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g. In some ways the differences appear minor. On the other hand, I think it is important that the FOMC adopt a report so that it can agree specifically on what it is trying to do and not leave this up to individual interpretations and misunderstandings. I think, too, we have to agree on what we do so we can explain it to the public. It is even more important that the Committee regularize its procedures so that the future blue books and reports of the Manager deal specifically with the critical questions which the Committee needs to know in order to operate. We should avoid a situation where any new member of the Committee can be given not one but several different concepts of what the Committee does, how it does it, and what it has been attempting to do in any current period.

Chairman Burns remarked that when he came to the Board in early February he did not know what the current policy stance of the Open Market Committee was. He read the directive then in effect but did not understand it; and in discussing it with his fellow Board members he was offered more than one interpretation. Thus, while he had not lived with the problem as long as other Committee members, much of what Mr. Maisel had said had a very real meaning to him.

As Mr. Maisel had noted, the Chairman continued, in the last several months the Open Market Committee had moved a fairly long way toward the recommendations of the directive committee. The question to be decided today was how much further to go. He was not sure what the wisest course would be at this point, although he thought the Open Market Committee would want to proceed cautiously.

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The Chairman then suggested that Messrs. Morris and Swan, the other two members of the directive committee, be given an opportunity to comment before the meeting was opened for general discussion.

Mr. Morris remarked that the directive committee had tentatively agreed at the outset of its deliberations that it would be desirable for the Open Market Committee to adopt some mechanism that would give it better control over the course of the monetary aggregates, and the studies made by its staff had confirmed that view. The experience of the summer of 1968 offered a good illustration of the need for such a control mechanism. During that period growth in the aggregates had been much more rapid than any member of the Open Market Committee had desired, but there was no effective mechanism available for slowing that growth.

Thus, Mr. Morris continued, it had appeared that the real question was not whether the Open Market Committee should move to aggregate targets but which aggregate to adopt. A related question concerned the procedures that would facilitate communication among Committee members and between the Committee and the Manager. From his point of view, there were two main arguments for selecting total reserves for target purposes. First, it seemed desirable to employ an aggregate which the Manager would be able to control

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reasonably well in a four-week interval. Total reserves admittedly were not completely within the Manager's control, but they were superior in that respect to, say, the money supply. Secondly, it seemed clear that the Open Market Committee was not prepared to adopt the money supply as an exclusive target; that it would continue to employ bank credit as well. His own feeling was that it would be inappropriate to rely solely on the money supply, partly because its short-run movements were so heavily influenced by fluctuations in Treasury balances. But whatever the preferences of a member between money and bank credit, and whatever growth rate he favored at a particular time for his preferred target variable, his objective could be translated by the staff into a target path for total reserves. Thus, total reserves offered a basis on which Committee members could come to a meeting of minds in terms of the instructions to be given to the Manager.

Mr. Swan said he would add only one observation. In recommending total reserves for target purposes, the directive committee did not mean to imply that it thought that variable was the appropriate one for defining the Committee's over-all goals or that its employment would resolve all of the problems of linkages among the aggregates. Total reserves were intended to serve only as a focal point for discussion and decision. In arriving at conclusions on their appropriate path the Open Market Committee would still have to consider the whole variety of factors that were relevant now, including such factors as the uses banks made of CD funds.

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The Committee then engaged in an extensive discussion of various aspects of the directive committee's report and related subjects.^{1/} The discussion ranged over such matters as the extent to which the Open Market Committee had been able to maintain effective control over the monetary aggregates during the period when the primary instruction of its directive had been formulated in terms of money market conditions; the nature and degree of discretion the Manager would have under the recommended procedure relative to past procedures; whether it was preferable for the Desk to seek to reach an aggregative target by aiming for the money market conditions believed consistent with that target or by operating directly through reserve totals; and the extent to which the range of fluctuation in weekly figures for the aggregates limited the usefulness of individual-week data for operating decisions.

There was a wide degree of agreement that the Open Market Committee's shift toward aggregative targets thus far in 1970 had been a desirable development and that the Committee should continue to pursue such targets. However, some speakers thought that the shift should still be considered as experimental. Also, certain differences of view emerged regarding the extent to which the Committee should continue to be concerned about short-run fluctuations in money market conditions and about the appropriate time horizon for establishing aggregative targets.

In comments on the desirability of a total reserves target, Mr. Francis said his reaction was favorable although he would have

^{1/} An informal supplementary memorandum, containing a more detailed report of the discussion than presented here, was in preparation at the time this memorandum was submitted to the Committee.

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preferred a money supply target. Mr. Galusha said he favored adopting a total reserves target on an experimental basis, on the understanding that appropriate attention would continue to be paid to market conditions. However, various objections to a total reserves target were expressed by most of those commenting on the subject. Several speakers expressed the view that it would be preferable to formulate targets in terms of the Committee's actual objectives, such as bank credit and money, and several commented that adoption of a total reserves target would represent a step backward from the procedures the Committee had already put into effect.

Near the end of the discussion Mr. Robertson expressed the view that the report of the directive committee--like that of the Mitchell-Ellis-Swan committee of 1964--represented a major contribution to an educational process in which the Open Market Committee had been engaged for some time. That process had been of great value; without it the Open Market Committee would not have been able to shift, after only brief consideration, to the type of directive in effect now.

However, Mr. Robertson said, it was his conclusion that no single variable such as total reserves could be taken as suitable for target purposes for an indefinite period ahead; the appropriate target would depend on the particular circumstances of the time. Accordingly, he thought the Open Market Committee should avoid any action that would limit its flexibility with respect to the selection of target variables from one meeting

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to the next. And he did not think a useful purpose would be served by issuing a public statement on the subject of the Committee's directive at this time.

Chairman Burns said he thought Mr. Robertson's observations could be taken as a statement of the Committee's consensus on the matter at hand. He (the Chairman) considered the directive committee report to be an excellent and thought-provoking document, but he believed that the Open Market Committee had in large measure already harvested its dividends.

The Chairman observed that it would be useful for the Open Market Committee to keep the directive committee's report in mind, although he did not propose that further discussion of that document be scheduled for any early meeting. He hoped the directive committee would continue to function, at least on an informal basis. In particular, it would be highly useful for the members of the directive committee to meet with the Manager, other key staff members, and himself to discuss the various matters on which the Manager had requested guidance in his statement this morning. As a result of its work the directive committee was in an excellent position to help the Open Market Committee achieve greater clarity in its instructions to the Manager.

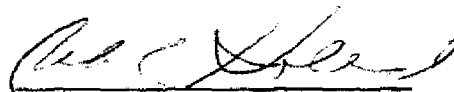
There was general agreement with the Chairman's proposal.

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It was agreed that the next meeting of the Federal Open
Market Committee would be held on Tuesday, May 5, 1970, at 9:30 a.m.

Thereupon the meeting adjourned.



Secretary

CONFIDENTIAL (FR)

April 6, 1970

Drafts of Current Economic Policy Directive for Consideration by the
Federal Open Market Committee at its Meeting on April 7, 1970

FIRST PARAGRAPH

The information reviewed at this meeting suggests that real economic activity weakened further in early 1970 while prices and costs continued to rise at a rapid pace. Fiscal stimulus, of dimensions that are still uncertain, will strengthen income expansion in the near term. Most long-term interest rates backed up during much of March under the pressure of heavy demands for funds, but then turned down in response to indications of some relaxation of monetary policy and to the reduction in the prime lending rate of banks. Short-term rates declined further on balance in recent weeks, contributing to the ability of banks and other thrift institutions to attract time and savings funds. Both bank credit and the money supply rose on average in March; over the first quarter as a whole bank credit was about unchanged on balance and the money supply increased somewhat. The U.S. foreign trade surplus increased in February, but the over-all balance of payments appears to have been in considerable deficit during the first quarter. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.

SECOND PARAGRAPH

Alternative A

To implement this policy, the Committee desires to see moderate growth in money and bank credit over the months ahead. System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining money market conditions consistent with that objective, taking account of the forthcoming Treasury financing.

Alternative B

To implement this policy, the Committee desires to see somewhat more growth in money and bank credit over the months ahead than sought at the preceding meeting. System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining money market conditions consistent with that objective, taking account of the forthcoming Treasury financing.