

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, May 5, 1970, at 10:00 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  
Messrs. Kenyon and Molony, Assistant  
Secretaries  
Mr. Hackley, General Counsel  
Mr. Partee, Economist  
Mr. Holmes, Manager, System Open Market Account

Mr. Baughman, First Vice President, Federal  
Reserve Bank of Chicago

Mr. Holmes noted that paragraph 1(a) of the continuing authority directive set a \$2 billion limit on changes in System Account holdings of U.S. Government securities during the period from the opening of business on the day following a Committee meeting to the

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close of business on the day of the next meeting. As a consequence of unsettled conditions in the Government securities market, the Desk had found it necessary to buy about \$1.8 billion of Treasury bills over the course of the last six business days. In view of the continued unsettlement in the market, and particularly in view of the uncertain prospects for the Treasury financing now in process, the Desk might well find it desirable to make purchases today in excess of the remaining leeway in order to maintain orderly market conditions and perhaps to assist the Treasury directly. And, if the unsettlement persisted, large-scale purchases might also be required in the inter-meeting period beginning with the opening of business tomorrow. Accordingly, he recommended that, for the period from the opening of business today until the close of business on the day of the next scheduled meeting--May 26, 1970--the Committee suspend the provision of paragraph 1(a) of the continuing authority directive limiting changes in holdings of U.S. Government securities between meetings to \$2 billion.

After discussion, the members agreed that the action recommended by the Manager was appropriate.

By unanimous vote, the provision of paragraph 1(a) of the continuing authority directive limiting changes in System Account holdings of U.S. Government securities between meetings of the Committee to \$2 billion was suspended for the period from the opening of business May 5, 1970, until the close of business May 26, 1970.

At this point the following entered the meeting:

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Mr. Broida, Deputy Secretary  
Messrs. Axilrod, Craven, Gramley, Hersey,  
Hocter, Jones, and Solomon, Associate  
Economists  
Mr. Coombs, Special Manager, System Open  
Market Account

Mr. Bernard, Assistant Secretary, Office of  
the Secretary, Board of Governors  
Mr. Cardon, Assistant to the Board of Governors  
Mr. Coyne, Special Assistant to the Board of  
Governors  
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. Melnicoff, First Vice President, Federal  
Reserve Bank of Philadelphia  
Messrs. Eisenmenger, Link, and Tow, Senior Vice  
Presidents, Federal Reserve Banks of Boston,  
New York, and Kansas City, respectively  
Messrs. Snellings, Scheld, and Green, Vice Presi-  
dents, Federal Reserve Banks of Richmond,  
Chicago, and Dallas, respectively  
Messrs. Gustus and Kareken, Economic Advisers,  
Federal Reserve Banks of Philadelphia and  
Minneapolis, respectively  
Mr. Cooper, Manager, Securities and Acceptance  
Departments, Federal Reserve Bank of New York  
Mr. Cox, Financial Economist, Federal Reserve  
Bank of Atlanta

By unanimous vote, the minutes of  
actions taken at the meeting of the  
Federal Open Market Committee held on  
April 7, 1970, were approved.

The memorandum of discussion for the  
meeting of the Federal Open Market Com-  
mittee held on April 7, 1970, was accepted.

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Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period April 7 through 29, 1970, and a supplemental report covering the period April 30 through May 4, 1970. Copies of these reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Coombs said the price of gold in the London market had risen to \$36.19 this morning, mainly reflecting the Cambodian situation. On the other hand, the foreign exchange markets remained remarkably quiet and orderly despite the strains that had developed in the domestic financial markets of many countries. Confidence in the present parity structure was still strong, and the forward markets were functioning smoothly and efficiently. As interest rate differentials had developed among the various centers, offsetting movements in forward rates had served to restrain flows of hot money from one center to another. He thought the only instance in which there currently was a major incentive to move funds was from the United States to Canada. Although price and wage trends varied considerably from one country to another, no country had been so successful in restraining inflation as to cause its currency to be labeled as a candidate for revaluation. Conversely, in those countries in which wage and price inflation was threatening the parity, speculation was still being held in check by severe fiscal or monetary restraint.

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More generally, Mr. Coombs continued, most major foreign currencies had been pushed close to their ceilings by the emergence this year of a very sizable deficit in the U.S. balance of payments, and there was again some talk in the market about the potential vulnerability of the dollar. At the same time, the market recognized that European needs for dollars to repay official debt and to replenish depleted dollar reserves would provide the United States with more or less automatic financing possibilities in certain currencies for at least some months to come.

However, Mr. Coombs observed, one might get a glimpse of things to come in the financing problems that were now developing in Switzerland, Belgium, and the Netherlands. Over the years the typical pattern had been one of large flows of dollars into continental European countries in the fall, which the Federal Reserve absorbed by drawing on the swap lines, followed by return flows which enabled the System to repay its drawings. This year the earlier heavy inflows of dollars had failed to reverse. One consequence was that the dollar holdings of the Swiss National Bank remained at the unusually high figure of more than \$600 million. Whether the Swiss National Bank would remain content to see its dollar holdings grow still further over the course of the year was an open question. And there had been further growth, rather than a decline, in Federal Reserve debt in Belgian francs. Finally, the System's swap debt in Dutch guilders remained outstanding, having reached its second three-month maturity towards the end of April.

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Mr. Coombs noted that at the preceding meeting Mr. Bodner had secured the Committee's approval of a further renewal of the guilder drawing if it proved necessary. In subsequent discussions, Dutch officials had suggested that the swap debt should not be allowed to run on beyond six months and had indicated that they would be willing to accept \$60 million of marks as part payment. That transaction was effected last week, reducing the Federal Reserve guilder debt from \$130 to \$70 million. The Dutch also had suggested that the balance of \$70 million might be cleaned up by a U.S. Treasury drawing of guilders from the International Monetary Fund, by sale of Special Drawing Rights, by sale of gold, or by some combination of the three. The U.S. Treasury had elected to make a drawing of \$70 million of guilders from the Fund, and would be doing so within the next week or so. The Treasury also had indicated its willingness to draw at the same time enough Belgian francs from the Fund to clear up the System's Belgian franc debt of \$130 million. Federal Reserve drawings on the Belgian line had been outstanding since last November.

On the other side of the ledger, Mr. Coombs said, he was glad to report that the Italian lira had stabilized during recent weeks, with only minimal market losses being experienced by the Bank of Italy. The provision last March of additional credit lines to the Bank of Italy by the System and the U.S. Treasury had, he thought, also facilitated Italian Government borrowing at medium term in the Euro-dollar market. As the members might know, the Italian electricity

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authority recently had raised \$425 million in such medium-term money, and tomorrow the Bank of Italy would be devoting \$200 million of the proceeds to paying down its swap debt to the Federal Reserve from \$800 to \$600 million. He thought it quite possible, barring serious political or social disturbances, that the Bank of Italy would be able to liquidate the remaining debt to the Federal Reserve completely before next fall.

By unanimous vote, the System open market transactions in foreign currencies during the period April 7 through May 4, 1970, were approved, ratified, and confirmed.

Mr. Coombs noted that two System drawings on the National Bank of Belgium would mature soon--one for \$25 million on May 25, 1970, and one for \$15 million on June 2. As he had indicated, he was hopeful that a Treasury drawing on the Fund would enable the System to clear up its Belgian franc debt. To provide against contingencies, however, he would recommend renewal of the two drawings if necessary. Both would be second renewals.

Possible renewal of the two drawings on the National Bank of Belgium was noted without objection.

Finally, Mr. Coombs said, he would recommend renewal of two \$200 million Bank of Italy drawings on the System that matured on May 19 and May 26, if the Italians so requested. Both would be first renewals.

Renewal of the two drawings by the Bank of Italy, if requested, was noted without objection.

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Chairman Burns then observed that along with Mr. Coombs he had attended the April meeting of central bank governors in Basle. He suggested that Mr. Coombs report on developments at that meeting.

Mr. Coombs said he could summarize briefly the impressions he had received from the discussions at Basle. It appeared that the German boom continued unbroken and that credit conditions were likely to be kept extremely tight in that country in an effort to deal with inflationary pressures. The Italian situation seemed to be characterized by a firm degree of credit restraint on the private economy. That restraint had been intensified by the recent increase in the Bank of Italy's discount rate, which had improved its alignment with Euro-dollar rates. However, there was a rather difficult situation in the budgetary area; the Bank of Italy was in a position in which it almost automatically had to finance a growing budget deficit. The main problem in Britain appeared to arise from the recent wave of very large wage increases in the face of extremely tight fiscal and monetary policy. The French situation was improving, and the Belgians and Dutch were holding about even.

Chairman Burns added that there was considerable interest evident at the meeting in the state of the U.S. economy, particularly in the prospects for the U.S. balance of payments. He used the word "interest" advisedly; while there was some concern about the U.S. balance of payments, he did not think it was very great.

The Chairman observed that there had been a newspaper report on the meeting which--while not very harmful in itself--had apparently been based on a leak. In view of that unfortunate event he had



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advised the members of the Federal Reserve family who frequently attended the Basle meetings to be especially discreet at future sessions.

Chairman Burns then noted that along with Messrs. Mitchell and Coldwell he had also attended the recent meeting in Chile of the Governors of the Central Banks of the American Continent. He invited Mr. Mitchell to comment on the meeting.

Mr. Mitchell noted that the Seventh Conference of Governors of the Central Banks of the American Continent was held in Vina del Mar, Chile, on April 28-29. All of the hemisphere's central banks were represented by their heads except those of Argentina and Canada, from which deputies attended. The discussion was led by the presidents of certain Latin American central banks, including Mr. Massad of Chile, Mr. Galveas of Brazil, Mr. Losada of Venezuela, Mr. Gomez of Mexico, Mr. Brown of Jamaica, and Mr. Bruce of Trinidad--all of whom struck him as outstanding men, well equipped for their posts by education and experience.

Mr. Mitchell observed that Chairman Burns' report on the U.S. economic situation and prospects was well received. However, some of the delegates differed with the view, which they attributed to the Chairman, that the difficult part of the task of fighting inflation--removing excess demand--had already been accomplished in the United States, and that only the easier part--controlling cost-push pressures--remained to be done. In the experience of these delegates, countering cost-push pressures was harder to achieve than the control of excess demand.

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Mr. Mitchell noted that there was a rather long discussion of flexible exchange rates and in particular "crawling pegs." The crawling peg technique is already in use in Chile, Brazil, and Colombia. The discussants seemed to feel that crawling pegs for developed countries would offer neither great advantages nor disadvantages to the less developed countries, but on balance the discussion left one with the impression of a favorable attitude toward somewhat greater flexibility in the rates of developed countries. One speaker expressed apprehension about the possible consequences of a shift to flexible exchange rates by the United States. However, he was reassured by Chairman Burns, who expressed the view that the United States had no intention of changing the existing relationship to gold.

The other main discussion topics were aid and interest rates, Mr. Mitchell continued. Mr. Galveas of Brazil, who had studied the growth of net reserves relative to exports in developed countries, came up with a rather pessimistic view of the prospects for aid. In his judgment net reserves were rising too slowly relative to exports to permit the developed countries to expand aid. He also expressed the view that in the 1960's private investment partially replaced Government aid. This observation led Mr. Brown of Jamaica to remark that he sensed a growing feeling in Latin America that foreign private investment might involve too great a sacrifice of national objectives. Although most countries represented apparently were not prepared to admit it, Mr. Brown's observation was supported by numerous examples of negotiated restraint on foreign ownership and control of business

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enterprise, including banking. For example, Canadian action in the Mercantile Bank of Canada case was cited as an appropriate way of coping with entry and growth of foreign banking.

As to interest rates, Mr. Mitchell said, the discussion was concerned mainly with means of attracting funds given the current high levels in developed countries. The hope was expressed that world interest rates would moderate shortly.

Mr. Coldwell observed that it had been clear in the discussion of flexible exchange rates that the countries now using the crawling-peg approach were quite pleased with the results. In the discussion of comparative interest rate levels Mr. Gomez of Mexico noted that his country was one of those laboring under the largest disadvantage and that it had taken steps to stop the flight of capital.

Mr. Coldwell remarked that in addition to attending the meeting he had visited the governors of a number of Latin American central banks in their own countries. In general, it was his impression that Latin America was a seething cauldron. The central banks were trying to hold down inflation in the face of rising government spending and pressures for higher wage rates and were having some limited successes. However, in virtually every major country there were strong elements of instability, grounded upon too-slow progress both in containing inflation and in improving the standard of living of the mass of poor people.

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At the Chairman's request Mr. Solomon then presented the following statement:

I shall use the time allotted for the usual international briefing to give the Committee a report on meetings of the Group of Ten Deputies and of Working Party Three, held in Paris the week before last.

The Group of Ten Deputies--with Undersecretary Volcker and Governor Daane representing the United States--held an intensive discussion of limited exchange rate flexibility. On the table was a brief document prepared at the Fund. As you know, this subject has been under discussion in the Fund's Executive Board for several months.

The major outcome of the Group of Ten meeting was the revelation that there is more support for, and less opposition to, limited flexibility than was indicated in the earlier discussions in the Fund. Most striking was the interest shown in small and more frequent changes in exchange rates--which some refer to as a crawling peg. And several delegates indicated a leaning toward a crawling peg with an upward bias. The possibility of a slightly wider band for exchange rate variation around parities did not arouse much enthusiasm.

The German and Italian representatives were joined by the Dutch in making a positive case for greater flexibility. And they were supported by the United States. Equally impressive was the fact that the French and Belgians expressed only very mild reservations. The most negative were the Japanese.

The upshot of the meeting was that the subject will continue under active discussion. The Fund Board is being encouraged to prepare a report for the September annual meetings and it is hard to see how that report can fail to reflect the favorable views expressed two weeks ago in Paris. Meanwhile, the Deputies will discuss the subject again in July. All in all, then, the subject of limited flexibility of exchange rates is still very much alive. Whether or not an amendment to the Fund's Articles of Agreement eventuates, a climate of opinion is being generated that makes greater flexibility more likely in the future.

The WP-3 meeting focused mainly on monetary developments in the major countries. I presented a report on

developments in the United States up to mid-April, pointing to the renewed expansion in the aggregates and the rather limited reductions in interest rates that had occurred up to that time. I must admit that I did not manage to predict what would happen to U.S. interest rates in the second half of April.

Considerable interest was expressed in the apparent change in the approach to Federal Reserve policy. The articles that had appeared in the U.S. press following release of the report on the January FOMC meeting had been given wide coverage in the European financial press.

I tried to provide some perspective for the Working Party by stressing that what was involved was a change in emphasis in FOMC procedures rather than a switch in the Federal Reserve approach to monetary policy from exclusive concern with interest rates to exclusive concern with the aggregates.

As developments in other countries were reviewed, it became clear that the overriding concern among European monetary authorities is the battle against inflation. Prices and wages are rising rapidly throughout Europe. Germany occupies a key position in terms of influence on other countries, and all the evidence points to the continuance there of strong demand pressures for some time. And, as in most other countries, monetary policy is being heavily relied upon.

As a result interest rates have risen sharply in most European countries in recent months, and interest rate differentials have narrowed among countries.

The conclusions that emerged from the discussion were as follows: (1) The United States is ahead of the rest of the world in getting excess demand under control. (2) Until further progress is made in dealing with inflation outside the United States, there is not much scope for downward movements of world interest rates. Only the Belgian representative indicated a leaning toward some cooperative effort to reduce interest rates internationally. Oddly enough, the British Treasury representative raised a question about the appropriateness of combating wage-push inflation with monetary policy.

It was agreed that the relative change in interest rates as between the United States and Europe that had occurred up to mid-April had not caused serious tensions in international payments. If U.S. rates should fall further a few countries would be inclined to follow down, at least to some degree, but probably not many.

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In general, the Europeans are so preoccupied with their own inflation problems that they did not express much concern about the U.S. balance of payments. But this is not a state of affairs that can be counted on to continue.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering domestic open market operations for the period April 7 through 29, 1970, and a supplemental report covering the period April 30 through May 4, 1970. Copies of both reports have been placed in the files of the Committee.

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

Interest rates moved sharply higher over the period since the Committee last met, in a deteriorating market atmosphere that affected the equity market as well as the bond markets. Among the factors that went so far as to raise the spectre of possible financial panic in the eyes of some market observers were the continuing concern about the fiscal outlook and about the success of the Government's anti-inflationary program; puzzlement over the market implications of greater reliance on monetary and credit aggregates in the implementation of monetary policy; a shortfall of bill demand relative to dealer expectations, at a time when dealer portfolios were very high; the continued heavy demand on the capital markets; the decline in stock market values; and intensified concern about the financial health of some Wall Street firms. The new turn of events in Southeast Asia late last week added still another uncertainty to this already long list. All in all, it was not a propitious background for the Treasury refunding that was announced after the close of business on Wednesday. Markets quieted down a bit before the weekend, in part reflecting the price and rate adjustments already made, but an air of extreme uncertainty emerged yesterday that leaves the success of the Treasury financing in doubt.

The Treasury bill market ran into special problems as the period progressed. As you know, dealers had built up their bill portfolios after mid-March in anticipation of lower rates ahead, and at the time of the last meeting they were in the process of building them up further in anticipation of seasonal demand later in April. When that demand failed to live up to expectations and it became increasingly evident to the market that the Federal Reserve was permitting the money market to firm up somewhat, distress selling of bills got under way, and rates pushed sharply higher. At the close on Friday, dealers had succeeded in reducing their bill portfolios by about \$1-1/2 billion from the level prevailing on the comparable day before the last Committee meeting. While System purchases of over \$1 billion of bills last week helped stabilize the market momentarily, dealers still had more long bills than they wanted, and we purchased an additional \$668 million in an early go-around yesterday morning. In yesterday's rather chaotic market, regular weekly auction average rates of 7.18 and 7.49 per cent were established for three- and six-month bills, respectively, up 77 and 104 basis points from the levels established in the auction just preceding the last meeting of the Committee.

As the written reports to the Committee emphasize, open market operations over the period sought to work against a rapid expansion in the money supply and bank credit that was clearly running well ahead of the target levels sought by the Committee for April and to a lesser extent, if the projections can be believed, for the second quarter as a whole. In essence we became a rather reluctant supplier of reserves, pushing the Federal funds rate up by about 1/2 of a percentage point and net borrowed reserves to higher levels. This relatively modest firming of money market conditions might, in other circumstances, have resulted in only a minor adjustment of other short-term interest rates. But given the vulnerability of the Treasury bill market, the generally unsettled and rather cynical mood of the financial markets, and the wrench to earlier expectations of a further decline in interest rates, a very substantial interest rate reaction occurred. Given all the circumstances such a reaction was inevitable.

In conducting open market operations over this delicate period, we were concerned that the reaction take place before the Treasury had to set the terms of its May refunding, with the hope that the market could itself find a new trading level before the System entered

into a period of even keel. As you know, last week we conducted several large go-arounds to buy Treasury bills, one on Monday a week ago--prior to the weekly bill auction--when the Treasury bill market was as close to disorderly as I would care to see it, and two others on Friday and yesterday when it was apparent that dealers were again becoming restive with their still heavy long bill positions. Despite the massive injection of reserves on these occasions, we have been able so far to maintain the somewhat firmer money market conditions that appear consistent with the behavior of the money supply and the adjusted bank credit proxy, but it is clear that even keel considerations have now taken precedence.

The growing market realization that the Federal Reserve was paying more attention to aggregates in its policy deliberations was not the major factor in unsettling the markets, but it did play a part. The suspicions of some market participants that something of the kind was in the wind were confirmed with the publication on April 15 of the policy record for the January meeting of the Committee. Given the mood of the market--in part related to the technical position of the bill market--the reaction was, as noted earlier, more vigorous than it might have been at other times. In the heat of the moment I am sure that many of you--as we at the Desk--had a number of irate phone calls. A number of dealers have suggested that their willingness to take positions would be affected and that they would take to the sidelines with a wait-and-see attitude. I trust that things will calm down as exaggerated fears of widely fluctuating money market conditions are, hopefully, set at rest. I have had several suggestions from market participants that it would be helpful if the Committee provided a fuller explanation of just what the new rules of the game are. Provided it can be done, I would think that the timely publication of a well-reasoned article setting forth the rationale of greater emphasis on aggregates would be constructive for the market. Incidentally, a number of dealers are setting their economists to work to forecast the aggregates, and I wish them well in that arduous endeavor.

Looking to the future, the blue book<sup>1/</sup> contains new targets for the money supply and bank credit over the second quarter. It would be nice to set out with some

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<sup>1/</sup> The report, "Monetary Aggregates and Money Market Conditions", prepared for the Committee by the Board's staff.



degree of confidence the implications of these targets for open market operations and for money market conditions, but that is unfortunately not easy to do. Projections for the second quarter suggest--for what they are worth and on the basis of somewhat lower bill rate assumptions than may be realistic--that the aggregates will grow more rapidly than the suggested target of a 4 per cent annual rate for both bank credit and the money supply; about 1 percentage point more on the Board staff estimates and substantially more on New York staff estimates. If these projections are borne out--and if the Committee adopts the blue book targets--it would imply that the System might have to become a still more reluctant supplier of reserves and that money market conditions might have to be shaded on the firmer side after the even keel period has ended.

As mentioned earlier, the atmosphere has been anything but favorable for the current refunding of \$16.5 billion of Treasury securities maturing on May 15, of which \$4.9 billion are held by the public. Earlier hopes that the offering might include a prerefunding of issues maturing later in the year, to cut back future refunding operations at times of seasonal Treasury cash needs, had to be abandoned. But by last Wednesday market conditions had stabilized enough to encourage the Treasury to attempt a combined rights-cash offering. As you know, the books are open for one day only--today--for a public offering of \$3-1/2 billion of an 18-month 7-3/4 per cent note, discounted to yield 7.79 per cent. The purpose of this offering was to cover attrition on the total refunding and to raise \$1 billion or more in new money, thus obviating the need for another trip to the market before the end of the fiscal year. Tomorrow the books close on the offering of two reopened issues--the 7-3/4 per cent notes of May 1973, and the 8 per cent notes of February 1977.

The Treasury, quite naturally and properly, has been concerned about the success of its offering--particularly in the light of new developments in Southeast Asia, which occurred after the terms had been set.

In the uncertainty that prevailed yesterday it was hard to judge what the outcome of either the cash financing or the rights exchange might be. While the Treasury may be able to squeak by, the possibility of a failure cannot be ignored. The Treasury should be expected to do all it can with its own resources, but I believe that the System should be prepared to lend support if a near-emergency situation arises. Thus, unless the Committee objects, I would be prepared, if required in order to maintain orderly markets, to purchase rights, or any or all of the three new notes on a when-issued basis, or other coupon issues. We should also

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be prepared for direct borrowing by the Treasury from the System if the financing results in a cash shortage for the Treasury.

We would, of course, try to offset any unwanted reserve supply resulting from such operations by selling short bills or letting bills run off at maturity. Such action would not require any change in the continuing authority directive, but since it would represent a departure from our normal practice of avoiding operations in issues involved in a Treasury refunding I considered it desirable to bring the matter before the Committee. I hope that we will not have to support the Treasury operation directly but believe we should be prepared for any contingency.

As you know, the System holds \$11.5 billion of the May 15 maturities, and it would be desirable to split our subscriptions among the three securities being offered. I would plan to subscribe today to \$7.0 billion of the 18-month notes, and to split the remaining \$4.5 billion between the two longer notes, roughly in proportion to expected public demand.

In response to questions, Mr. Holmes said the Federal trust accounts held only a small amount of the May 15 maturities. The Treasury announcement of the \$3-1/2 billion cash financing had indicated that some additional amounts of the 18-month note offered would be sold to the Federal Reserve and the trust accounts, but had not mentioned any specific amounts. The market was not particularly concerned with the amount the Federal Reserve bought since it would expect that in the normal course of events the System would hold the notes until maturity.

In reply to questions by Mr. Brimmer, Mr. Holmes observed that the Treasury would in fact raise \$1 billion in new cash only if, in addition to sales to the public of \$3-1/2 billion of the 18-month note, the attrition on the exchange was held to \$2-1/2 billion, or 50 per cent. To expect an attrition rate of only 50 per cent now

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might well be optimistic. Moreover, it was possible that sales of the new note to the public might come to less than \$3-1/2 billion.

If the net proceeds of the combined operation fell short of needs, Mr. Holmes continued, the Treasury might announce that it would borrow directly from the System any additional funds it required during the remainder of the fiscal year, thus providing reassurance that it would not be back in the market before June 30. There were, of course, other possible ways in which the problem might be handled; for example, the System could go into the open market to buy rights, or it could advise dealers that it was prepared to bail them out if necessary. However, such courses would raise legal and/or policy problems, and he hoped they could be avoided. As he understood it, the Treasury would not favor them either. Direct Treasury borrowing from the System seemed to him to be the cleanest and best means of coping with the problem.

Mr. Mitchell asked whether any such borrowing was not likely to be of considerably longer duration than customary.

Mr. Holmes replied that the borrowing was likely to remain outstanding for a number of weeks, rather than the usual few days. In view of the seriousness of the situation, however, he would not consider that inappropriate.

Mr. Holland noted that such a development would not be without precedent. At one point during World War II a Treasury borrowing from the System had remained outstanding for several weeks.

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Mr. Maisel asked about the probable effects of operations of the kind under discussion on the monetary aggregates. After some comments were made on this matter, Mr. Mitchell remarked that any effects would be temporary--although of uncertain duration--since at some point it would be possible to withdraw any reserves supplied now in connection with the Treasury financing.

Mr. Heflin commented that the problems being discussed pointed up the need to give the Manager guidance concerning the appropriate interpretation of "even keel" under the Committee's present policy of placing increased emphasis on the aggregates. He hoped that question would be considered later in the meeting today.

Mr. Brimmer agreed that the question was one that needed resolution. He thought, however, that the problem under discussion went well beyond the usual even keel considerations, since it concerned the risk of disorderly markets during a financing.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period April 7 through May 4, 1970, were approved, ratified, and confirmed.

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

Mr. Partee made the following statement concerning economic developments:

Major new uncertainties have emerged in the economic picture over recent weeks. Potentially most significant, of course, is the new military involvement in Cambodia. The principal commitment of U.S. troops there is expected to last only 6 to 8 weeks, in which case the economic effects would be small. But it is impossible to judge at this point what all of the ramifications of the broadened area of conflict might be, especially since there has been nothing definitive in the way of response yet from the other side. At the least, it would seem possible that the changed situation could lead to delays in scheduled troop withdrawals from Vietnam, and hence in expected reductions of defense expenditures in the months ahead.

Another dramatic development has been the sharp sustained drop in stock prices throughout the past month. Broad stock market indexes, such as the New York Stock Exchange composite, have dropped by an eighth or more, thereby extinguishing something on the order of \$100 billion in market values. Investors apparently were reacting partly to poor first-quarter earnings reports which, according to our tabulations, were down about 10 per cent on average from a year ago on an after-tax basis for manufacturers. Before-tax profits dropped appreciably more than this, but the cut in the surtax reduced the impact on net. In addition, a more general pessimism has been evidenced in the market, reflecting such factors as the state of the brokerage business, the turnaround in the money market, and the presumed lack of progress toward solution of our major economic problems. Most recently, of course, the military situation has put the market down further.

It seems evident that the stock market, if it continues to decline or even fails to rally, will be having an unfavorable impact on the real economy. Partly this stems from the psychology of a falling market on business and consumer expectations, which are likely to turn more bearish with growing financial uncertainty. In addition, lower stock prices may have a wealth effect on expenditures, by reducing the market value of financial asset holdings, and serve to raise the effective cost of equity capital to business. These factors have considerable weight in the Board's econometric model. Reducing stock values by one-eighth, while holding all other

factors unchanged, reduces consumption \$6 billion and GNP \$11 billion by year end from what otherwise would be projected. This may be extreme, since interest rates at least would probably be more stimulative, but it does provide some indication of the possible quantitative impact.

A third development of some importance has been the outbreak of wildcat strikes by truckers in a number of major industrial centers. What is at stake here is whether the labor settlement in this industry will be the one negotiated by the national union, which calls for increases in total compensation averaging nearly 9 per cent per annum over a 39-month period, or something larger. This in itself is a commentary on the probable difficulty of reaching labor contract settlements this year. But meanwhile the strikes are having an increasing impact on production, deliveries, and employment in affected industries. We think that this will force some decline in the industrial production index in April. And secondary layoffs resulting from delivery problems have become sizable--probably involving around 100,000 workers currently. Such layoffs have been a factor in the recent renewed uptrend of unemployment insurance claims, and may have contributed also to a further rise in the unemployment rate in April. Preliminary indications are that the rate was 4.8 per cent, with the increase again concentrated among adult males. These figures have just been received, and are extremely confidential until released publicly, probably late this week.

Other economic news during the past month has been mixed. New orders declined appreciably in March, and order backlogs dropped for the third month in a row. Manufacturer's inventories, on the other hand, showed only a very small increase, a good sign that the inventory correction is proceeding rapidly. Retail sales were about unchanged in March, but weekly data indicate a slight increase in April. Nondurable goods are showing moderate strength, while automobile dealers' and some other durable sales continue weak. New car deliveries, however, improved sharply in late April. For the first quarter as a whole, total retail sales in real terms were unchanged from the fourth quarter and 2-1/2 per cent below a year ago.

The McGraw-Hill survey taken in April again indicates the apparent continuing strength of business capital spending plans for 1970. Compared with last

fall's survey, manufacturers' anticipations have been revised down somewhat but spending plans in other areas have strengthened. The over-all rise for the year now shown by this survey is 9 per cent. Machinery and equipment orders declined slightly in the first quarter, however, and partial results from a National Industrial Conference Board survey indicate substantially more downward than upward revisions for the year among manufacturing firms. Under the circumstances, our projection still shows an 8 per cent rise in capital outlays in 1970, but I continue to think that a shortfall is probable.

One of the main surprises in the March data was the further sharp rise reported in housing starts. The increase, to an annual rate close to 1.4 million units, principally reflected continuing unexpected strength in multi-family projects. This may reflect in part seasonal aberrations, but it also is beginning to appear that there is more financing for such projects than we had anticipated. Accordingly, we have revised upward our second-quarter housing starts projection, although we still expect a decline from the recent levels to about a 1.2 million rate. Unfortunately, we have had also to revise upward our estimate of the second-quarter increase in the GNP price deflator. Although there are now more signs of moderation in the price rise, especially in foods but also in some non-food commodities, the first-quarter increase in the deflator was substantially larger than we had expected.

With these exceptions, the staff GNP projection remains broadly as presented to the Committee in the previous green book <sup>1/</sup> supplement. Real GNP is expected to level out this quarter, reflecting mainly the special income stimulants to consumption and a smaller drop in inventory investment, and to turn upward again in the second half of the year. The projected second-half rise is limited by declining defense spending and a slowing of the increase in capital outlays, however, and amounts to a relatively moderate 3-1/2 per cent annual rate in real terms. The high employment budget should also be turning somewhat more restrictive as the second half progresses

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

and markedly so in the first half of next year. And we still expect that the rate of inflation will diminish gradually as the year progresses.

Our standard projection therefore continues to indicate the desirability of holding to a moderate rate of monetary expansion. But I must emphasize that we have allowed for neither a major reaction in business and consumer behavior to the fall in the stock market, nor to the possibility of larger military spending requirements than had been projected in the January budget. For the time being, the former seems to me the most pressing problem. I would think it highly desirable, even aside from the immediate Treasury financing requirements, to avoid any significant further increase in market interest rates that would give the impression of cumulating difficulties in financial markets. At the same time, however, we need to resist any unnecessarily large deviation from a moderate growth path in money and credit, since this would be inimical to the Committee's longer-run stabilization objectives. To the extent that additional credit must be supplied because of the present market situation, efforts will need to be made to withdraw it gradually later on.

Mr. Axilrod made the following statement concerning financial developments:

Since the last meeting of the Committee stock prices have dropped quite sharply and there has also been a relatively sharp upward adjustment in market interest rates, with mortgage rates so far appearing to be an exception. The extent of this rebound in interest rates has amounted to about 40-60 basis points in the long-term area and to about 70-90 basis points for Treasury bills and bankers' acceptances. Long-term Treasury issues and new high-grade corporate bonds have moved slightly above their late-1969 cyclical peaks, while municipal issues are only slightly below their peak. In short-term markets most yields remain around 60-100 basis points below the previous peaks.



These developments have been explained at some length in the various documents presented to the Committee. I would like to put some additional stress on three interrelated and overlapping explanations. First, the sheer weight of massive supply in long-term markets has had a naturally depressing effect on prices. Second, this effect on prices has been magnified by disappointed expectations as to the rapidity with which monetary policy was going to ease and by concerns about the future course of fiscal policy. And, thirdly, the changes in the term structure of interest rates--with short-term rates down on balance thus far this year and long-term rates basically unchanged--is in large part, and in my judgment, a reflection of shifts in liquidity preference of borrowers, lenders, and the public generally.

With respect to borrowers, corporations appear to be putting considerably more stress on long- rather than short-term financing. Partly this reflects the need to compensate for an unbalanced corporate financial structure that has resulted from the great extent to which liquid assets have been economized and bank lines have been utilized over the past few years to accommodate external financing requirements. Outstanding business loans at banks actually appear to have declined slightly in the course of March and April, even after including loans sold to affiliates--and, at least in March, this was accompanied by a reduction in the rate of borrowing in the commercial paper market. Unfortunately, we do not have the statistics to evaluate whether this reduction in business loans is primarily because of an acceleration in repayments or a deceleration in extensions. We presume some of both has been involved, although reports from banks, though mixed, remain suggestive of fairly strong loan demands.

Another aspect of the enhanced demand for liquidity has been seen in the behavior of institutions. Banks have increased their holdings of securities by an estimated \$5 billion over the past two months, a period in which outstanding total loans made by banks have declined by about half that amount. Part of this rise in securities did reflect earlier expectations of declining interest rates, but liquidity preferences

also appear to be important. The increase in U.S. Government securities holdings appears to be largely in the bill area, while the rise in other securities includes for the most part short-term municipal securities. Moreover, savings and loan associations have improved their liquidity positions in the past month or two. It is a nice question, of course, as to how much of the improvement in institutional liquidity is wanted by banks and others and how much unwanted. To a degree, it would certainly seem to be desired--given the sharp erosion of liquidity over the past year and the uncertainties about the sustainability of continued inflows of time deposits--but to an extent the investments in short-term market securities may also reflect, for S&L's, the difficulty of finding mortgages in view of the start-up time required in the construction industry. For banks, the availability of investment funds may result from abatement of business needs for short-term funds and, more recently, from reduced demands of security dealers. In other words, at least some of the liquidity improvement must be an aspect of current economic weakness.

Yet another element in liquidity demands may be reflected in increased desires for cash balances. It is most difficult to evaluate whether any such increased demand for cash is transitory or permanent--let alone attempting to determine whether it in fact exists given the imperfection of our money supply statistics. My judgment in current circumstances is that there has been some shift in the demand for cash, largely for precautionary reasons in light of stock market uncertainties and partly as individuals and others permit cash balances to rise, perhaps transitorily, in the process of making difficult decisions between spending and interest-earning investments in an environment in which future economic prospects and cash flow are quite uncertain.

One of the questions for monetary policy is whether to accommodate itself to increased demands for liquidity and cash balances. The rise in both short- and long-term interest rates since the last meeting of the Committee is consistent with the view that policy is not being completely accommodative--although it is no doubt true that expectational factors

have been affecting interest rates to a degree so that rates can by no means be completely explained by the relationship between liquidity demands and the operations of the central bank to accommodate them.

In view of the uncertainties about how much progress is being made in containing inflationary pressures, it appears desirable for policy not to be completely accommodative to shifting liquidity demands. Satisfying such demands too quickly could lead to resurgence of inflationary spending. Moreover, we are not all certain what the demand for liquidity really amounts to, and it may be that the economy has over the past few years learned to live with relatively little liquidity. On the other hand, this type of argument can easily be overdone. Given the need to stimulate the mortgage market and in light of continued relatively weak consumer spending, I would think that it would be a desirable course for policy to accommodate at least part, and possibly a considerable portion of, liquidity demands. To be specific, I would supply enough bank reserves to avert, at a minimum, further significant increases in market interest rates and would not be averse to seeing or even encouraging declines from current advanced levels, provided that the growth rates of money and bank credit remain on the moderate side when averaged out over a number of months.

One would expect an abatement of credit market pressures to require the money supply and the adjusted bank credit proxy to begin rising, after the several weeks of decline--much more pronounced for money than bank credit--that followed the end-of-first-quarter bulge. The blue book's adjusted paths for money and bank credit are predicated on such a rise. But in evaluating trade-offs among money, bank credit, and interest rates, I would this time put more stress on sustaining a reasonable growth in institutional credit from banks and nonbanks and encouraging moderation of interest rate pressure--hoping that this might not require more growth in the money supply than shown in the blue book but recognizing that over the short run it might. An abatement of pressures in credit markets might have a salutary psychological effect on the stock market, would increase the willingness of lenders to begin making mortgage commitments at a more rapid pace, and might lead to a more stable kind of environment for rational decision-making by businessmen and consumers.

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Mr. Holland reported that since distribution of the draft directive a revised version had been prepared which took account of suggestions made on the earlier draft at three points.<sup>1/</sup> In the first paragraph, the opening sentence had been revised into two sentences, and a modification had been made in the statement regarding interest rates; and in the second paragraph a proviso clause had been added.

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

Mr. Hayes said it seemed increasingly clear that there would not be a significant recession this year. The information that had become available in the past few weeks strongly suggested to him that the economy was about to turn the corner, if it had not already done so. The evidence was not unmixed, but he thought most indicators were stronger on balance than they had been a month ago. In his judgment the main risk now was of a resurgence of demand.

The latest McGraw-Hill survey tended to confirm the strength of capital spending plans, Mr. Hayes remarked.

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<sup>1/</sup> The draft directive originally submitted by the staff for consideration by the Committee and the revised draft are appended to this memorandum as Attachments A and B, respectively.

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From his own conversations with businessmen he had concluded that attitudes toward capital spending remained buoyant. The housing outlook appeared to have strengthened a bit, as Mr. Partee had noted. The fact that consumers had spent the bulk of the increment to their disposable income in the first quarter raised the odds, he thought, that they would react similarly in the current quarter to the income injections from the increase in social security benefits and the Federal pay raise. The Indochina situation was an area of uncertainty, but it might well develop into a major stimulus to Federal spending.

Any deterioration in the budget position would, of course, increase the Government's borrowing requirements, Mr. Hayes continued. Such an increase, in turn, could make it more difficult for the System to hold growth in the monetary aggregates down to moderate rates. Estimates of borrowing requirements for the second half of the year already were rising into a relatively high range.

Mr. Hayes noted that the GNP projections made by the Board's staff were close to those prepared at the New York Bank. However, the latter were less optimistic with respect to the course of the price deflator. In contrast to the Board staff's projection that the rise in the deflator would be down to a 3.7 per cent annual rate by the fourth quarter, the New York

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Bank projected that the increase would not fall below 4 per cent this year. Of course, all such projections were highly conjectural.

Turning to the balance of payments problem, Mr. Hayes noted that less progress had been made thus far in 1970 than had been hoped for. In the first quarter the over-all deficit on the official settlements basis exceeded the surplus that had been recorded in the full year 1969, and the trade surplus was smaller than had been expected. Thus, there was reason for considerable concern with the problem of inflation on international as well as on domestic grounds.

Mr. Daane said he demurred from Mr. Hayes' apparent willingness to assume away the possibility of recessionary tendencies in the economy. Nor did he think one could afford to ignore the possible effects on economic developments later in the year of existing conditions and expectations in financial markets. His own view was that there was now a real risk of a collapse of confidence, although he doubted that such a collapse would actually occur and he noted that the System could help forestall one by appropriate action. As to the buoyancy of capital spending plans, he had detected some feeling on the part of the Federal Advisory Council at its recent meeting with the Board that survey results of the kind Mr. Hayes had mentioned tended to overstate the actual volume of spending.

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In general, Mr. Daane observed, he had no quarrel on economic grounds with the staff's GNP projections. However, he thought it was much too soon to discount the various kinds of uncertainties that now existed.

Mr. Swan commented that it had been the objective of policy to achieve cutbacks in capital spending. One had to distinguish between changes in psychology that led to desired results and changes that could be described as a collapse of confidence. In his judgment the latter were not imminent.

Mr. Daane expressed the view that recent developments in financial markets, including the stock market, suggested that expectational changes had already passed beyond the desirable type.

Mr. Coldwell remarked that he had gathered from conversations since his return from South America that earlier expectations of further easing in monetary policy had been disappointed. Also, rightly or wrongly, people no longer believed that fiscal policy would remain stringent. And there appeared to be greatly increased concern about wage strikes and campus unrest. All of those concerns apparently were being reflected in the stock market declines.

Mr. Hickman said he thought there had been a cataclysmic change in expectations over the last two months--resulting from

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such developments as the postal strike and the events in Indochina-- which had had a decided impact on the stock market. The evidence in terms of economic statistics that had become available since the last meeting, while spotty, suggested to him that the economy had stabilized. They indicated that the Committee might perhaps be more concerned soon about too rapid a resumption of growth and additional inflationary pressures than about the risk of additional slack in the economy.

Mr. Hickman remarked that he agreed in general with Mr. Partee's assessment of the economic outlook. The strong points in the situation included the recent sharp decline in business inventory investment, the sharp growth in personal and disposable income and consumer spending, the deficit in the high employment budget in the second quarter--which might be offset by surpluses later in the year, but at the moment represented a stimulative factor--and the recent McGraw-Hill survey of capital spending plans of business, which indicated continued strength in that sector for 1970 and beyond. He shared Mr. Daane's view that survey results overstated actual capital spending because for almost a year he had been hearing from businessmen that they were paring back their planned outlays. However, actual spending appeared to be holding up.

Chairman Burns suggested that that might be due in part to a "money illusion." Businessmen, thinking in physical volume terms,



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could be speaking about cutbacks from plans while dollar outlays were rising because of increasing costs.

Mr. Hickman said that might well be true. He went on to note that the economic evidence was likely to continue spotty for some time, as was always the case at or near turning points in activity. The weakness in the March figures for new orders and the upward revision in residential construction outlays were cases in point. He believed that real GNP would begin to increase sharply after the settlement of the truck strike in the Midwest. The workers who had been laid off because of the truck strike would not be reemployed for a week or two while the pipelines were being refilled, but he thought that a substantial rise in real GNP would begin around late May.

Mr. Heflin said there were three key questions bearing on the Committee's policy decision today, but the evidence was not yet in on two of them. One of these related to expectations. They were in a state of flux, and since March they may have been moving back into an inflationary pattern; but one could not yet be sure. The second related to the effect on the Federal budget of recent developments in Southeast Asia. Perhaps the current operation would have no great impact on total defense outlays. On the other hand, the experience of 1965 might be repeated.

The third question, Mr. Heflin continued, concerned the state of the economy. The evidence suggested to him that the best

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to be hoped for was a sluggish recovery over the next two quarters. However, he was less worried now about a recession than he had been a month ago.

As to open market operations, Mr. Heflin noted that there would be an even keel constraint over the next ten or twelve days. He thought that even keel considerations should be dominant; and as he had suggested earlier in the meeting he believed the Committee should give the Manager explicit instructions on that point. In view of the shaky state of the market the Manager should be given a wide degree of leeway.

Mr. Heflin added that, after participating in the morning call for the past month, he was impressed with the difficulties of interpreting the current figures on the monetary aggregates. He found it even more difficult to place much faith in the dependability of the projections.

Mr. Brimmer observed that he agreed with Mr. Hayes' analysis. He recalled that at the February meeting there had been considerable sentiment within the Committee to the effect that a serious recession was in prospect later in the year--while some members, including himself, had resisted that conclusion. Today the Committee was faced with a similar uncertainty. He was not disturbed by Mr. Partee's suggestion that the drop in stock prices might have a substantially depressing effect on consumer spending. Indeed, he took some comfort in such a prospect, given the

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outlook for increased Federal expenditures in both the defense and nondefense areas. A turnaround in real GNP of the degree projected by the staff--from a decline in the first half to growth in the second half at a 3-1/2 per cent rate--would not appear to offer a climate conducive to dampening inflationary expectations.

In the short run, Mr. Brimmer said, it obviously was important to avoid a financial panic and to give the Manager the leeway necessary to that end. But that was not the same as suggesting that the System should undertake to bail out securities dealers. Like any other business, dealer firms should be expected to bear the risk of losses in their operations.

Mr. Mitchell said he thought the Committee's approach thus far, which he would describe as one of gradualism, had produced the sequence of events needed to achieve its goals. Demands of the household sector were moderating; contrary to the views of some, he saw no evidence that the demands of the Government sector were about to rise explosively; the performance of the stock market indicated that inflationary psychology there had been tranquilized; and the banking system appeared convinced that the Federal Reserve meant business.

In short, Mr. Mitchell remarked, he thought the System had turned the corner in its effort to make a moderate change in the stance of monetary policy. He saw no need to be concerned about the bullish flare-ups that would occur from time to time. The

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Committee's major problem now was that of achieving the amount of monetary expansion that would insure economic recovery at a moderate rate in the fall of 1970 and on into 1971.

Mr. Kimbrel commented that his confidence in the intentions of bank management in the Sixth District had been strengthened in recent weeks by the fact that the banks had used their enlarged inflows of time deposits mainly to improve their liquidity positions rather than to expand loans rapidly.

The business picture in the District remained mixed, Mr. Kimbrel said. People in the automobile industry expected sales during the next few months to be below present levels. Construction contracts were continuing to increase, but chiefly for nonresidential construction; in the residential area the vacancy rate was rising.

Mr. Kimbrel added that he had the impression from talking with District businessmen that inflationary expectations were once more building up--not as a result of the System's policies but as a consequence of the belief that the kind of fiscal actions to be expected in an election year would lead to trouble before many months had passed. He very much hoped that an outbreak of a new inflationary spiral could be avoided.

Mr. Francis remarked that recent economic developments indicated that the policy of monetary and fiscal restraint was operating on schedule. There was no basis for complacency, but as he had watched economic developments unfold he had seen nothing that

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indicated a need to deviate from the Committee's planned course of monetary action.

Economic developments in the first quarter, and since, had contained no surprises, Mr. Francis said. The growth of total spending continued to moderate, while the high rate of inflation persisted. That was what should have been expected; an inflation that had been allowed to build up for five years could not be reversed quickly.

A look at most recent developments did not suggest to Mr. Francis that downward forces were cumulating in such a way as to threaten a serious recession. Industrial production had moved up slightly in March, payroll employment had continued upward, and inventories had not been building up excessively. At the same time, inflationary forces did not seem to be intensifying. Wholesale industrial prices showed signs of slowing, and stock prices were behaving anything but bullishly. Those were scant bits of evidence, but he felt, nevertheless, they provided some basis for encouragement.

In his judgment, Mr. Francis continued, the budget was not deviating significantly from the January plan, except for the timing of the Federal pay increase and the larger increase apparently forthcoming for postal workers. What was important was that expansion in monetary aggregates be maintained, but kept moderate. Forces had been set in motion to reduce the rate of inflation by late 1970 and early 1971. Quickened expansion of monetary growth--in response to, say, Treasury demands for cash, or inappropriate consideration

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of trends in bank credit--could nullify the effects of the fiscal and monetary restraint that had already occurred. On the other hand, retreating from a policy of moderate monetary growth could have the effect of reducing real output more than was actually desirable.

Mr. Baughman said he still viewed the GNP projections of the Board's staff as reasonable in light of the available evidence and as acceptable targets for monetary policy. It appeared that Seventh District businessmen had a roughly similar outlook in mind in making their plans and commitments. At the moment, however, the most significant development in the District was the effect of the truckers' strike, which was spreading more and more widely and gradually strangling activity.

Turning to individual industries, Mr. Baughman remarked that there seemed to be a firmly held view that a turnaround was in process in the automobile industry and that both production and sales would increase in the second quarter unless prevented by the truckers' strike. Sales of construction equipment were surprisingly good for an industry that had not expected to be doing well at this time. Activity in the farm machinery industry was improving about in line with expectations from recent very low levels.

As to prices, Mr. Baughman observed that he was still not at all sure that there were any indications of a significant slowing in the rate of advance.

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Mr. Baughman then said that he might report on the unusual public interest shown in the Chicago area in the 18-month note the Treasury was offering for cash in the current financing. Well over 4,000 people--many of them housewives--had come to the Bank yesterday to enter subscriptions, compared with a maximum of about 300 in the regular Treasury bill auctions. In addition, so many telephone inquiries were received that people calling the Bank on other business frequently could not get through. The reasons for the unusual interest were not clear. In particular, it did not appear to have been stimulated by the press, since the news stories regarding the offering, carried on Friday, had been quite routine. And the public evidently had not been attracted by the small \$1000 denominations no longer available on Treasury bills, since most of those at the Bank yesterday were subscribing to larger amounts.

Chairman Burns asked whether a similar situation had developed at other Reserve Banks.

Mr. Morris observed that the experience at his Bank was quite similar. Mr. Clay said the number of people entering subscriptions at the Kansas City Bank had been surprisingly large, although not as large as at Chicago. Mr. Holmes reported that the number coming to the New York Bank had not been unusually great, but there had been a deluge of telephone inquiries about the financing.

The Chairman then suggested that the Committee turn its attention to financial developments and prospects.

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Mr. Mitchell referred to Mr. Axilrod's earlier comment that it would be desirable at this time to put more stress on sustaining reasonable growth in institutional credit from both banks and non-banks, and asked how that could be done most effectively.

Mr. Axilrod replied that the most important requirement would be a lower level of Treasury bill rates, since the current level was inimical to the flows of funds to institutions. He suspected that a large part of the money the public was investing in the new Treasury note was being withdrawn from banks and other thrift institutions. He would be prepared to see more short-run growth in the money supply than called for in the blue book, if that were necessary to bring down bill rates.

Mr. Mitchell asked how much more growth in the money supply might be required; what the implications would be for growth in bank credit; and whether the objective might not be achieved by an increase in Regulation Q ceilings rather than by a reduction in bill rates.

Mr. Axilrod noted that the blue book suggested 4 per cent annual rates of growth as targets for the second quarter for both money and the adjusted bank credit proxy. He thought growth in money in the second quarter at a 5 or 6 per cent annual rate might be needed to get bill rates down to a desirable level. He hadn't worked out the implications for bank credit, but would guess that the adjusted proxy series might expand at a rate in the 4 to 6 per cent range. In his judgment it would be better, under current conditions, to seek



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lower bill rates than to raise Q ceilings for the purpose of sustaining growth in institutional credit at a reasonable rate.

Mr. Brimmer observed that the "current projections" for the second quarter shown in a table distributed on the same day as the blue book--annual rates of growth of 4.7 per cent for the adjusted proxy series and 5 per cent for money--were higher than the target rates of 4 per cent for both suggested in the blue book.

Mr. Axilrod said the difference reflected the fact that the projections represented expected growth rates on the assumption of no change in money market conditions, whereas the blue book targets were intended to involve no change from the concept of "moderate growth" implied by the targets agreed upon at the previous meeting. The new targets for the individual aggregates differed from the old because, in the staff's judgment, the relationships had changed.

Mr. Hayes suggested that it would be helpful to include the projections as well as the suggested targets in the blue book. Although they tended to fluctuate widely in the short run, the projections were extremely important from the point of view of day-to-day operations.

Mr. Partee remarked that that could be done if the Committee so desired. He would be concerned, however, about possible confusion resulting from the multiplicity of figures. He noted that the projections--which often could be expected to differ a little

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from the targets--were readily available in other places, including the Manager's report.

Mr. Morris referred to Mr. Partee's earlier report that the unemployment rate was tentatively indicated to have increased to 4.8 per cent in April, with much of the advance involving adult males. In his (Mr. Morris') judgment, that information added to a pattern that seemed to be developing in the current statistics. As Mr. Brimmer had noted, considerable concern had been expressed about the economic outlook at the Committee's February meeting, and a number of members had indicated then that they expected data for the next few months to reflect further deceleration. However, actual developments had led the staff to make substantial upward revisions in its GNP projections for the year. At present conditions in financial markets and the latest economic statistics suggested that the tide might be running the other way; he suspected that the odds favored downward, rather than upward, revisions in the GNP projections over the next few months.

At the same time, Mr. Morris continued, he had no strong convictions about the course of the economy over the rest of the year. Until a better assessment was possible he thought it would be desirable to follow a middle course with respect to policy. But the case for resolving doubts on the side of ease seemed to him to be stronger than it had been four weeks ago.

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Mr. Hickman said he would expect the economic statistics for May to be quite weak because of the truckers' strike.

Chairman Burns remarked that Mr. Hickman's expectation might be unduly pessimistic, if judged by the results of a study he (the Chairman) had made in 1956 of the effects of strikes of nationwide significance in such major industries as coal and steel. He had found that it was difficult to detect such a strike in over-all data for the economy in the absence of prior knowledge concerning it--even though activity in the specific industry affected might have collapsed.

Chairman Burns then noted that much was being said about inflationary expectations in current discussions of economic matters. As he examined information on the economy he found no evidence of strong inflationary expectations on the part of consumers. On the contrary, consumers presently were saving at an abnormally high rate. The stock market certainly was not reflecting such expectations. His information on real estate markets was limited, but he had the impression that while prices were high they were rising at a less rapid rate than previously.

The surveys of capital spending plans did suggest that the expectations of businessmen were inflationary, the Chairman continued. The evidence indicating what the actual course of investment spending might be was mixed; the information on orders for durable goods and on machine tool orders suggested that such spending would be weaker

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than the survey results indicated. Like Mr. Partee, he expected the dollar volume of investment outlays to rise in 1970, but by less than the surveys indicated.

There was little doubt, the Chairman remarked, that businessmen were concerned about inflation and about the outlook for fiscal policy. The latter concern was deeply felt in the business community, although not so deeply as in the financial community, and it had grown considerably in recent months.

One had to take into account such attitudes of businessmen, Chairman Burns observed, since attitudes were facts that had consequences in themselves. Nevertheless, it was important to bear in mind that present expectations for fiscal policy in business and financial circles were out of perspective. A change in thinking about fiscal policy had been set off initially by the Administration's announcement that it was releasing funds that had been impounded earlier for State and local government construction projects. However, according to Budget Bureau estimates, the maximum amount of funds involved in this fiscal year was \$175 million--and that maximum would be reached only if governments displayed more efficiency in their operations than was characteristic of them. The shift in attitudes had been gravely accentuated by the postal strike and the subsequent legislation raising the pay of postal and other Federal workers. But the resulting increase in estimated Federal expenditures was not great enough to make much of a change in the over-all fiscal

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picture; indeed, it was unlikely that there would have been the present alarm had it not been for the experience with Federal budgets in other recent years. There were good grounds for expecting part of the rise in expenditures to be financed by added revenues. Moreover, he thought it likely that the Administration would announce soon some retrenchment in certain categories of expenditure.

The Chairman noted that the Cambodian development, which had occurred while he was in South America, was the latest source of concern about fiscal policy. Because of his own concern, on returning from abroad he had explored the implications for Federal expenditures as thoroughly as possible, drawing on sources that he considered excellent. The subject was, of course, marked by uncertainty, and he intended to do some further checking. It was his present impression, however, that--barring some response from Communist China, which could not be ruled out--the Cambodian development would not have much effect on Federal expenditures. The fact that the contrary view was widely held in financial markets had, of course, had an impact on those markets and had contributed to the problems faced by the Desk in recent days.

The Chairman then expressed the view that insufficient attention had been paid in the discussion today to the problem of unemployment. Referring to the comments that had been made about earlier excessive pessimism in expectations for the economy, the Chairman said the unemployment rate had risen faster than he, among

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others, had expected. At 4.8 per cent the unemployment rate already was about at the level the staff had projected would be reached late in the year; and it was well over the 4.3 per cent average for the year the Council of Economic Advisers had anticipated.

In conclusion the Chairman said he thought it would be a disastrous mistake to tighten monetary policy at this time, but that relaxing would also be a serious mistake. In his judgment the present track of policy was sound, and he favored holding to it.

Mr. Hayes remarked that he had arrived at the same conclusion. He added that the Chairman obviously had far better sources than he regarding the probable budget impact of developments in Cambodia, and he fervently hoped that the impression the Chairman had received on that subject would prove to be accurate. At the same time it was worth noting that from past experience one might conclude that the executive branch of the Government was not always the best judge of such matters.

Chairman Burns then called for the go-around of comments and views on monetary policy. Mr. Hayes made the following statement:

I believe the greatest danger we could face would lie in a relaxation of policy that would tend to confirm and strengthen current widely-held fears that the authorities are giving up on the effective use of fiscal and monetary policy to break the inflationary spiral. In other words, our basic stance should be one of firm restraint.

In translating this into a more specific policy directive for the next three weeks, we have to deal with a perplexing combination of circumstances. To

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my mind moderate growth in the money and bank credit aggregates remains a proper intermediate policy objective. The general ranges discussed at the last meeting still seem reasonable. While the interrelationships between money supply and bank credit, on the one hand, and interest rates and GNP, on the other, are by no means certain, I don't object to the new blue book targets. In view of the sharp rise in interest rates of recent weeks and the consequent increased uncertainty in the outlook for reintermediation, I think money supply deserves greater attention than bank credit for the time being. Since current projections--such as they are--point to a rather excessive rate of money growth for the second quarter--one that could spark new fears of inflation--there would be reason on this score to move toward somewhat firmer money market conditions. However, we are in the midst of an even-keel period, when confidence in the Government securities market, and in financial markets generally, is more shaky than it has been in several years. Indeed, the fear of disorderly financial markets in general is now stronger than at any time in recent years. Under the circumstances, the Manager should, I think, give a good deal of weight in the coming three weeks to money market conditions and market psychology. With the market tending to exaggerate the scope of the policy change expressed in the January 15 directive, it would seem to behoove the System to demonstrate by deed that our sole concern is not with the aggregates, but that we are still vitally interested in the proper functioning of the markets. Of course, to the extent that these market problems may tend to take care of themselves, the Manager would be able to give more weight to the pressing need for a sufficient check to excessive monetary expansion.

Mr. Morris said that he would accept the policy called for by the revised draft directive distributed today. Since the latest economic indicators were a little weaker than he had expected, however, he would not be overly concerned if the Desk's efforts to maintain orderly markets resulted in growth in the aggregates at rates above the targets.

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Mr. Coldwell expressed the view that market stability was the critical need in the present circumstances, and he hoped the Desk would place a high priority on maintaining stability. An even keel was clearly required in light of the unusual nature of the Treasury financing.

Mr. Swan commented that he also would accept the revised draft directive. He recognized the necessity for giving market conditions a high priority in the period immediately ahead. However, he shared Mr. Hayes' views regarding the aggregates, and he would want the Desk to take the aggregates into account to the extent possible. He would be somewhat concerned if the money supply grew at the rate Mr. Axilrod had mentioned in connection with his recommendation to seek lower bill rates.

Mr. Galusha expressed support for the revised draft directive.

Mr. Baughman said he also found the revised directive acceptable. However, the Committee might want to consider amplifying the statement in the first paragraph noting that attitudes in financial markets were being affected by developments in Southeast Asia. The Manager had mentioned certain other factors affecting the current market atmosphere--such as continuing concern about the success of the Government's anti-inflationary program--that might also be mentioned.

In his judgment, Mr. Baughman continued, the Desk's recent posture had been appropriate to the objective of keeping the market functioning, and in light of the rather rapid increases in interest



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rates he would favor a continuation of about the same posture. The Board might want to consider a further increase in the Regulation Q ceilings for the purpose of achieving somewhat more rapid growth in bank credit relative to money at the current level of interest rates.

Mr. Clay commented that the Committee seemed to be generally on course with respect to the policy it had been following since January. In his judgment, however, growth in money and bank credit in the past month was somewhat more rapid than desirable, and the 4 per cent rate suggested as a target for money in the second quarter was a little high. He hoped it would be possible to achieve more moderate growth rates for the aggregates, although he recognized that such a task would not necessarily be easy. The revised draft directive submitted by the staff was acceptable to him, and he agreed that the Manager should be given considerable flexibility for the period immediately ahead.

Mr. Heflin said he found the revised draft directive to be satisfactory.

Mr. Mitchell said he also was satisfied with the revised draft directive. It should be recognized, however, that the Manager would be taking the actions needed to maintain orderly markets, whatever the implications for the aggregates. He would not be concerned if the consequence was a large increase in money during May. He would be quite disturbed, however, if money continued to increase rapidly in June and July.

Mr. Daane said he would agree in general with the comments made by Mr. Morris. Clearly, the immediate need was to maintain orderly conditions in financial markets, and that required an even keel in the traditional sense of the term. Following a traditional even keel at this time would also have the advantage of dispelling the market's belief that the Committee was focusing exclusively on the aggregates.

While he supported the sense of the draft directive, Mr. Daane continued, he was troubled by the proposed insertion of the words "bank reserves" in the clause of the second paragraph reading "System open market operations...shall be conducted with a view to maintaining bank reserves and money market conditions consistent with that objective...." He had no quarrel with the purpose of the addition, as set forth in the explanatory notes attached to the directive draft.<sup>1/</sup> However, the directive notes were not a published document, and the language of the directive itself might mislead the reader into believing the Committee was calling for an increased degree of fine tuning.

Chairman Burns commented that some suitable means should be found for avoiding such a connotation.

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<sup>1/</sup> The note in question read as follows: "A reference to 'bank reserves' as well as to 'money market conditions' is suggested in the statement of instructions to help make clear that in reaching his operating decisions the Manager is expected to keep an eye on the path of changes in the whole family of reserve aggregates. The staff understands that deviations from that path are expected to be used as information supplementing--not substituting for--developments in money market conditions as a guide to possible Desk operations."

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Mr. Partee remarked that the Committee's intention could be made clear by including the substance of the explanatory note in the text of the policy record that would be published along with the directive.

Mr. Daane commented that such a procedure would be useful.

Mr. Maisel said he agreed with Mr. Partee's estimate of the economy and was satisfied with the probabilities. On the financial side, he agreed with Mr. Axilrod. Financial markets were far from buoyant. If anything, their action would seem to indicate higher probabilities of a liquidity crisis than of an excess of liquidity.

Against that background, it seemed to Mr. Maisel that operations since the last meeting had moved along the proper path. The sharp increases in the monetary aggregates were not ignored as they would have been under a purely accommodative policy following a change in money market conditions. Instead those movements were taken into account in the rate at which reserves were furnished. The dealers and lenders following previous precedents took a tremendous speculative position. The fact that they had to abandon it was probably healthy. The past month also showed how erratic week-to-week data could be but at the same time how useful it was to be following a target path well laid out. The Committee had made a much better policy turn than he thought had been typical of past turns.

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The question facing the Committee, Mr. Maisel continued, concerned the path for the next three months that would be suitable. Unfortunately, the problem was made difficult because the July projections seemed to have been left out of the blue book. He assumed they had been omitted because they would give no additional information on the path. Still, he would have preferred to have them, and he hoped three-month projections would be provided in the future so that each member of the Committee could make up his own mind on this point.

Mr. Maisel noted that the target paths shown in the blue book reflected staff estimates of a possible trade-off between the money supply, the adjusted bank credit proxy, and total reserves. He would prefer that, for this coming period, more weight be given to the adjusted bank credit proxy and total reserves than to the narrowly defined money supply. His reason was that he believed liquidity was extremely short as a result of the low rates of growth in the aggregates that had persisted for the past year. During that period growth in the credit proxy probably had been negative, while the money supply had grown by 2.8 per cent. At the same time, of course, the economy's spending actually went up 6 per cent. That large difference in rates of growth explained a lack of liquidity in the economy.

Mr. Maisel observed that if the Committee were to accept the target paths laid out in the blue book it would find that by

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the end of June  $M_1$  would have grown at an annual rate of 3.9 per cent for the current half-year; the adjusted credit proxy would have grown at a 2.4 per cent rate; and total reserves would have fallen at a 1.2 per cent rate. Clearly, those rates were not sufficient to furnish current liquidity, without taking into account any possible prior shortages. Therefore, he would be happier if for the current quarter the Committee set its targets for growth in each of the aggregates at least 1 percentage point higher than indicated in the blue book--that is, 5 per cent for the adjusted proxy and the money supply and 1-1/2 per cent for total reserves.

Furthermore, Mr. Maisel continued, he would not be concerned if the adjusted proxy and total reserves grew even faster than the target--although, primarily for psychological reasons, he would not want to see an annual growth rate of over 6 per cent for  $M_1$  for this quarter. Even with such a rate the money supply would have grown slightly under 5 per cent for the current half-year.

Mr. Brimmer said he was troubled by the suggestion by Mr. Axilrod and several Committee members that growth rates in the aggregates in excess of the blue book targets should be sought or at least accepted. He personally found the blue book target rates barely acceptable, and would prefer less rapid growth. The need to work toward controlling the aggregates was particularly important

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in light of the tendency he had noted since mid-February for actual growth to exceed the target rates. There would be relatively little time between the end of the Treasury financing and the next meeting of the Committee, but he hoped the Manager would do what he could in that period to reverse preceding large reserve injections and to offset tendencies toward excessive aggregate growth rates.

Mr. Brimmer added that he had no objection to including the words "bank reserves" in the second paragraph of the directive. He agreed that it would be desirable to include explanatory material in the policy record.

Mr. Sherrill said he concurred in Mr. Mitchell's comments on the economic situation. It appeared that excess demand had been tranquilized and that the business sector was in a good position to move ahead at a reasonable pace after having successfully accomplished most of the needed inventory adjustment. If it were not for the disturbed conditions in financial markets, including the stock market, he would be quite satisfied with the over-all situation.

As to policy for the forthcoming period, Mr. Sherrill continued, he thought the blue book targets for the aggregates were quite acceptable. As others had noted, however, the target rates might well be exceeded as a result of the Manager's efforts to cope with problems in the market. Indeed, it would be fortunate if actual growth could be moved back to rates near the targets by the next meeting. Nevertheless, he hoped the Manager would give

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as much consideration as possible to the effects of his operations on the growth of bank credit.

Mr. Hickman said that he considered appropriate the targets suggested in the blue book for growth in both bank credit and money at a 4 per cent annual rate in the second quarter. Given the problems that would be facing the Desk in the next few weeks he doubted that much could be done now to assure that those targets would be met, but he hoped that any excesses would not be great. He considered the proposed directive language to be excellent, although he thought the reference to bank reserves did not add much and could be omitted.

Mr. Eastburn said he would accept the revised draft directive. He added that, like Mr. Heflin, he was concerned about the meaning of even keel in the context of the current increased emphasis on the aggregates. Perhaps the staff could be asked to prepare a memorandum on the matter.

Chairman Burns agreed that such a memorandum would be helpful, and Mr. Axilrod indicated that one would be prepared.

Mr. Kimbrel remarked that if he had a choice he, too, would accept the revised draft directive. He hoped the Manager would resolve any doubts on the side of tightness rather than ease.

Mr. Francis said that, in the current situation--with both continued rapid inflation and sluggishness in real output--policy should avoid the extremes of either rapid monetary expansion or no

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expansion for a prolonged period of time. He suggested that the Committee's target for money growth should remain at the 3 per cent annual rate adopted earlier this year rather than the faster rate suggested in the blue book. The June target level for money suggested in the blue book would represent an increase at about a 6 per cent annual rate from February, which was the end of the period of no net growth in money and about the time that policy was changed to seek moderate expansion. He saw no reason for raising the target growth rate for money either for its own sake or as a compromise designed to avoid a sharper downward revision in the bank credit target. The recent rise in interest rates above Regulation Q ceilings had led to a forecast of renewed disintermediation of time deposits and a contraction in bank credit, and the System should not interpret that as monetary restraint. To get money back down to the 3 per cent growth path adopted in February, it was necessary that System open market operations should be conducted so as to provide for about a 4 per cent annual rate of decrease from the two weeks ended April 29 until June.

In sum, Mr. Francis concluded, he could not support the directive if, as he understood it, that would imply acceptance of the targets suggested in the blue book. He feared that the adoption of those targets would undo over the next two months much of the good that monetary policy had accomplished over the past several months.



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In response to the Chairman's request for comment, Mr. Axilrod remarked that rates of change in aggregates could, of course, be measured from a variety of bases, and as Mr. Francis had noted the Committee had adopted the objective of moderate growth in the aggregates in February. However, from the point of view of evaluating the impact of policy on the economy, he thought there was much to be said for considering the trend of the aggregates over a longer period--perhaps from October or November of 1969. That procedure would yield a lower average growth rate for money.

Mr. Francis agreed that the growth rate calculated would be smaller if an earlier base were used. For the reasons he had mentioned, however, he considered February to be the appropriate choice. Moreover, in terms of absolute levels the June target given in the blue book struck him as higher than desirable.

Chairman Burns expressed the view that the nature of the Committee's policy decision in February was not necessarily decisive with respect to the choice of a base for measuring recent changes in the money stock.

Mr. Robertson made the following statement:

I think the proper course for monetary policy today is, in a careful but determined way, to keep fostering the orderly adjustment of our long overheated economy. It may be that we have bottomed out in the decline in real economic activity, and that a moderate resumption of growth lies ahead of us. If so, that is laudable if, and only if, we experience some corresponding cooling of prices. I was heartened by the first harbingers of a hopefully better price performance to which the staff

was finally able to point; but further progress on this front is absolutely essential if the use of our general stabilization tools to achieve noninflationary prosperity with growth is to be vindicated in this environment.

I am glad we are having some success in rolling back the bulge in money supply and bank credit that developed in March and early April, and that the staff now sees us returning to a path that could fairly be called one of moderate growth over the second quarter. I have no concern, myself, with bulges in the aggregates that last only a few days or a week or two; but those which threaten to be of longer duration I think should be resisted, and I am glad the Manager managed to tighten up on reserve availability and money market conditions enough to do just that. I am also glad that he did not tighten money market conditions any more than he did, given the sensitive state of the markets and the delicate balance of the current Treasury financing. Having Regulation Q ceilings still in place, I would point out, was a key factor enabling the Manager to slow down bank credit growth with no more reserve pressure than he applied. Distasteful though those interest rate ceilings may be, in principle, they still are demonstrating their pragmatic usefulness.

Looking ahead, I am satisfied with the goals for moderate growth in money and bank credit outlined in the blue book. I recognize that "even keel" will have to be an overriding consideration for much of the time between now and the next meeting of the Committee, but I hope that the Manager will do what he can within that constraint to promote a climate of moderate--not immoderate--monetary expansion. Even though participants may be tugging on markets in ways that suggest strong desires for more liquidity, I think our long-range objectives for the economy are best served by our maintaining an orderly and moderate monetary response. Having come this far along that road, I think we should fight the temptation to alter our stance now.

Accordingly, I would favor the draft directive as presented by the staff, essentially unchanged from last time.

The Chairman said he agreed with all of Mr. Robertson's comments except those pertaining to Regulation Q. He thought a rough consensus had emerged from the go-around. Most members seemed

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ready to support the revised draft directive, although there had been suggestions for further revisions. Similarly, most seemed to agree, more or less, with the targets for the aggregates suggested in the blue book, although preferences had been expressed for both slightly lower and slightly higher growth rates.

Mr. Hayes said it was his impression that there was a little more sentiment for lower growth rates than higher.

Mr. Daane referred to Mr. Baughman's earlier suggestion for expanding the sentence in the first paragraph of the directive referring to the factors affecting attitudes in financial markets. He (Mr. Daane) thought that an addition also would be desirable to the list of factors cited in that paragraph as contributing to the recent increases in interest rates. He had in mind the possible shift in liquidity preferences that Mr. Axilrod had noted in his statement today.

Chairman Burns expressed the view that additions of the types proposed by both Mr. Baughman and Mr. Daane would be desirable. He suggested that the Committee vote on a directive consisting of the revised draft distributed earlier, amended to include the proposed additions. In view of the lateness of the hour the specific language for the additions might be left to the staff, subject to the concurrence of Messrs. Daane and Mitchell.

There was general agreement with the Chairman's suggestion.

With Mr. Francis dissenting, the Federal Reserve Bank of New York was authorized and directed, until otherwise

directed by the Committee, to execute transactions in the System Account in accordance with the following current economic policy directive:

The information reviewed at this meeting indicates that real economic activity weakened further in the first quarter of 1970. Growth in personal income, however, is being stimulated in the second quarter by the enlargement of social security benefit payments and the Federal pay raise. Prices and costs generally are continuing to rise at a rapid pace, although some components of major price indexes recently have shown moderating tendencies. Most market interest rates have risen sharply in recent weeks as a result of heavy demands for funds, possible shifts in liquidity preferences, and the disappointment of earlier expectations regarding easing of credit market conditions. Prices of common stocks have declined markedly since early April. Attitudes in financial markets generally are being affected by the expansion of military operations in Southeast Asia and by concern about the success of the Government's anti-inflationary program. Both bank credit and the money supply rose substantially from March to April on average, although during the course of April bank credit leveled off and the money supply receded sharply from the end-of-March bulge. The overall balance of payments was 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 bank reserves and money market conditions consistent with that objective, taking account of the current Treasury financing; provided, however, that operations shall be modified as needed to moderate excessive pressures in financial markets, should they develop.

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The Chairman then noted that a memorandum from Mr. Partee, entitled "Proposed new summary of District developments," had been distributed on April 30, 1970.<sup>1/</sup> He asked Mr. Partee to comment.

Mr. Partee remarked that the purpose of the memorandum was to propose that the Committee experiment with a new report, perhaps to be known as the "red book," that would present the most significant economic information coming to the attention of the Reserve Banks since the previous meeting. The report might be distributed on the same time schedule as the green book and would supplement the latter by emphasizing qualitative rather than quantitative information and company, industry, or regional developments rather than national developments. It was proposed to place responsibility for preparing the new report with the Committee's five Associate Economists from the Reserve Banks.

Chairman Burns observed that one purpose of the new report, as he understood it, was to permit the Committee to draw to a greater extent than at present on the knowledge of Reserve Bank people, including the directors. The emphasis was placed on qualitative information, such as opinions and judgments, partly because such information could be kept quite current; the quantitative information on which the Committee now relied so heavily necessarily lagged actual developments.

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<sup>1/</sup> A copy of this memorandum has been placed in the files of the Committee.

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Mr. Hickman said he had no objection to the proposed report. He thought, however, that the Reserve Banks might be a source of some quantitative information that would usefully supplement that given in the green book. For example, the GNP projections prepared at his Bank had on occasion proved better than those prepared at the Board.

The Chairman agreed that it might be desirable to include some quantitative information.

Mr. Hayes said he was happy that the proposed report had been described as an experiment because there was some chance that the costs might exceed the benefits; sometimes he felt that the material being prepared for the Committee's use had grown so voluminous as to be almost counter-productive. Nevertheless, he started out with a bias in favor of the proposal.

After further discussion it was agreed to proceed with the proposed report on an experimental basis.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, May 26, 1970, at 9:30 a.m.

Thereupon the meeting adjourned.

  
Secretary

ATTACHMENT A

May 4, 1970

Draft of Current Economic Policy Directive for Consideration by the  
Federal Open Market Committee at its Meeting on May 5, 1970

The information reviewed at this meeting indicates that real economic activity weakened further in the first quarter of 1970, but income expansion is being stimulated in the second quarter by the enlargement of social security benefit payments and the Federal pay raise. Prices and costs generally are continuing to rise at a rapid pace, although some components of major price indexes recently have shown moderating tendencies. Most market interest rates have risen sharply in recent weeks as a result of heavy demands for funds and the disappointment of earlier expectations of further easing of credit market conditions. Prices of common stocks have declined markedly since early April. Attitudes in financial markets are being affected by the expansion of military operations in Southeast Asia. Both bank credit and the money supply rose substantially from March to April on average, although during the course of April bank credit leveled off and the money supply receded sharply from the end-of-March bulge. The over-all balance of payments was 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 bank reserves and money market conditions consistent with that objective, taking account of the current Treasury financing.

May 5, 1970

REVISED

Draft of Current Economic Policy Directive for Consideration by the  
Federal Open Market Committee at its Meeting on May 5, 1970

The information reviewed at this meeting indicates that real economic activity weakened further in the first quarter of 1970. Growth in personal income, however, is being stimulated in the second quarter by the enlargement of social security benefit payments and the Federal pay raise. Prices and costs generally are continuing to rise at a rapid pace, although some components of major price indexes recently have shown moderating tendencies. Most market interest rates have risen sharply in recent weeks as a result of heavy demands for funds and the disappointment of earlier expectations regarding easing of credit market conditions. Prices of common stocks have declined markedly since early April. Attitudes in financial markets are being affected by the expansion of military operations in Southeast Asia. Both bank credit and the money supply rose substantially from March to April on average, although during the course of April bank credit leveled off and the money supply receded sharply from the end-of-March bulge. The over-all balance of payments was 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 bank reserves and money market conditions consistent with that objective, taking account of the current Treasury financing; provided, however, that operations shall be modified as needed to moderate excessive pressures in financial markets, should they develop.