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, December 12, 1967, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Brimmer
Mr. Francis
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Scanlon
Mr. Sherrill[1/]
Mr. Swan
Mr. Wayne

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

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

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

Mr. Cardon, Legislative Counsel, Board of Governors
Mr. Fauver, Assistant to the Board of Governors

1/ Entered the meeting at the point indicated.

Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Reynolds, Adviser, Division of International Finance, Board of Governors
Mr. Axilrod, Associate Adviser, Division of Research and Statistics, Board of Governors
Miss Eaton, General Assistant, Office of the Secretary, Board of Governors
Miss McWhirter, Analyst, Office of the Secretary, Board of Governors

Messrs. Eisenmenger, Link, Eastburn, Mann, Taylor, Andersen, Tow, and Green, Vice Presidents of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Atlanta, St. Louis, Kansas City, and Dallas, respectively
Mr. Lynn, Director of Research, Federal Reserve Bank of San Francisco
Messrs. MacLaury and Meek, Assistant Vice Presidents of the Federal Reserve Bank of New York
Mr. Kareken, Consultant, Federal Reserve Bank of Minneapolis

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on November 14, 1967, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee held on November 14, 1967, was accepted.

By unanimous vote, the action taken by members of the Federal Open Market Committee on November 30, 1967, increasing effective as of that date the swap arrangement with the Bank of Canada by $250 million equivalent, from $500 million to $750 million equivalent, and the corresponding change in paragraph 2 of the authorization for System foreign currency operations, was ratified.

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 November 27 through December 11, 1967. A copy of this report has been placed in the files of the Committee.

In supplementation of the written reports, Mr. MacLaury said that the announcement on Thursday, December 7, of a $475 million drop in the Treasury's gold stock seemed to have been accepted by the markets as about in line with prior expectations of the costs of the gold rush following sterling's devaluation. What the market did not know, of course, was that only a $250 million purchase of gold from the United Kingdom saved the United States from a still larger loss in the face of some foreign central bank buying, notably the $150 million purchase by Algeria. The actual pool settlement for November took place last Thursday and Friday, December 7 and 8; the U.S. share of the $836 million total was $495 million. The logistical acrobatics of providing sufficient gold in London were performed with a minimum of mishaps, although the accounting niceties were still being ironed out.

Of greater concern, however, was the fact that the drain on the pool was accelerating again, Mr. MacLaury observed. Last

week there was a small net surplus, but yesterday the loss was $56 million and today $95 million; for December to date, the pool was in deficit by $183 million. Some of the demand shortly after devaluation apparently represented large individual purchases by Eastern European countries, Communist China, and possibly Middle Eastern countries, although demand was more general in the last two days.

On the whole, it was Mr. MacLaury's impression that the measures taken by the Swiss commercial banks and by some other continental banks to impede private demand for gold worked quite well, although it was clear from the start that such measures could serve only as a stop-gap until some fundamental change was agreed upon. Persistent newspaper leaks--mainly from Paris--about current discussions on this subject and their reflection in gold market activity Monday and today pointed up the need for speed in reaching a decision. Mr. Hayes was in Basle this past weekend and might want to say a few words about recent developments. So far as the prospect for further declines in the gold stock were concerned, the Stabilization Fund now had on hand about $100 million. He knew of no firm purchase orders at the moment, although there was a distinct possibility that Italy might want to buy $100 million before the end of the year to recoup its losses through the pool. No one could say, of course, how many

orders might be received from other quarters, but it would be surprising if there were not some.

In the exchange markets, Mr. MacLaury continued, sterling unfortunately was again in the spotlight. As he had reported at the previous meeting, covering of short positions in sterling had tapered off considerably by the second week following devaluation, and last week saw the rate bounce around erratically with absolutely no dollar intake by the Bank of England. In fact, by Friday the authorities had to provide substantial support, as they did again yesterday, at a total cost of nearly $200 million. That renewed pressure probably reflected in part the general nervousness that persisted in the markets despite a surface appearance of calm. But he personally found it difficult to explain except in terms of liquidations by sterling holders, i.e., either British residents--despite exchange restrictions--or members of the sterling area. It certainly seemed that previously taken short positions in sterling were not being closed out, but rather were being extended--with the result that the forward discount, in the absence of official support, was widening. That in turn meant that even with short-term interest rates in the United Kingdom at crisis levels, there was no incentive to move funds in for investment. In fact, despite an easing in the Euro-dollar market, the incentive on a comparison with local authority rates favored the Euro-dollar market.

Obviously, the situation was highly disturbing and quite unpredictable, adding an unanticipated element of uncertainty to an already unsettled post-devaluation world. In the meantime, the Bank of England had used $600 million of its immediate post-devaluation dollar gains to reduce drawings under its swap arrangement with the System--$300 million in November prior to announcement of November reserve losses of $364 million (not counting the $490 million taken into reserves as a result of the sale of Britain's remaining dollar portfolio), and $300 million on December 4.

On the continent, Mr. MacLaury said, the picture had been mixed but on the whole not too unsatisfactory for the dollar. Since he had last reported to the Committee, only the Swiss had taken in any sizable amount of dollars ($113 million). Although they had not asked for exchange cover on those dollars, the New York Bank was in the process of working out means for dealing with those recent inflows as well as for paying off previous Swiss franc drawings which had just recently passed the six-month mark. One matter of some concern was the fact that although the Swiss authorities had indicated to the market their willingness to take in dollars on a swap basis to provide year-end liquidity, as they had in previous years, so far the market had been reluctant to repurchase dollars for January delivery, preferring to sell the dollars outright. On the other hand, there had not been any

demand for forward Swiss francs, although the Swiss National Bank had offered that facility as agent for the United States.

In contrast, Mr. MacLaury remarked, the German Federal Bank had provided forward cover back into marks at sufficiently attractive rates to induce an outflow of nearly $600 million during the last week of November, reversing previous inflows and providing sizable redeposits in the Euro-dollar market with noticeable effect on rates in that market. The Federal Reserve Bank of New York would draw $300 million on the arrangement with the German Federal Bank, in effect sharing responsibility for the forward cover provided to the market. In addition to the shift of funds from Germany to the Euro-dollar market, the Bank for International Settlements from time to time had drawn on its swap with the Federal Reserve to place Euro-dollar deposits when rates seemed to be firming. The total of such drawings as of yesterday was $245 million.

Mr. MacLaury observed that although the German case was the most striking example of central bank operations following the meeting in Frankfurt, the availability of forward cover into guilders and Belgian francs at reasonable rates had also helped to reassure the market. Federal Reserve forward commitments in guilders and Belgian francs as a result of those operations amounted to $18.8 million and $4.9 million equivalent, respectively, matched by equal commitments by the Treasury.

France seemed to have lost a substantial amount of dollars--approaching $100 million--in the last two weeks, Mr. MacLaury noted, presumably reflecting the conversion of French franc holdings by Algeria, and possibly Iraq, to finance gold purchases from the United States. There were still no firm indications on the prospects for a purchase of gold by France itself, although some rumors implied that a purchase was not a foregone conclusion. Sweden and Canada also had continued to lose reserves, although for reasons quite different from France. In both of those cases the total reserve drain since devaluation amounted to more than $100 million.

Altogether, Mr. MacLaury concluded, the situation remained very fluid. The statements and actions of central banks during the brief period since sterling's devaluation had helped immeasurably to keep the markets under control. In that connection he would note particularly the increases in the System's swap lines announced on November 30. Nevertheless, the weeks ahead might well bring a number of surprises, and on balance they were likely to be unpleasant. Certainly, the last of the fallout from the devaluation of sterling had not been seen.

Mr. Maisel asked why the British had stopped providing forward cover for sterling.

Mr. MacLaury replied that he had no direct information on the Bank of England's reasons for not resuming forward operations

in the period since devaluation. Certainly, he thought, they had anticipated a situation far different from that they had in fact faced. It was clear from their actions that until the last few days, when pressures became very heavy, they had not been prepared to provide support to the spot market so long as the spot rate was above par. It was not inconceivable that they would again undertake forward operations, but a decision to do so evidently had not been made as yet.

In response to another question by Mr. Maisel, Mr. MacLaury said that for the last few months South Africa had been adding to its gold reserves at the rate of about $10 million a week. Accordingly, while some of their newly produced gold had been reaching the London market in that period, the amount was below normal.

Mr. Sherrill entered the meeting at this point.

Mr. Brimmer referred to an article in today's press quoting a French newspaper to the effect that Algeria had bought from France the dollars it had used to acquire gold from the United States, and that France might be encouraging other countries in the French franc zone to do the same. He asked Mr. MacLaury to comment on that report, and also on the likelihood that other franc-zone countries would follow the same route.

Mr. MacLaury replied that he certainly would not rule out the possibility that the French authorities were using the tactic

described, but he had no firm knowledge that they were. He doubted that the Algerians had bought dollars directly from the Bank of France. More likely, they had sold francs for dollars in the market, thereby weakening the franc and leading to market sales of dollars by the Bank of France in support of the rate. The effect of such market operations was, of course, little different from that of a direct transaction. With respect to the second question, while he would not count Iraq among countries in the French franc zone there might have been some French influence in that country's recent purchase of $21 million of gold. There had been a $20 million order for gold from the former Belgian Congo which had now been postponed until January. He had no information concerning possible gold purchases by other countries.

Mr. Hayes said it was his understanding that under the arrangements in effect within the franc zone the French had an obligation to pay out dollars for francs if requested by, say, the Algerians.

In reply to a question by Mr. Robertson, Mr. MacLaury said he would estimate that the Bank of France now held about $800 million in dollars, after allowing for their November accruals and their more recent sales.

Mr. Galusha noted that recent favorable developments in Britain, such as the settlement of the railway strike, had not

seemed to allay the market's fears about sterling. He asked what kind of news might reassure the market.

Mr. MacLaury said he doubted that any further statements would have much effect at this point; the proper statements had already been made. There had also been some statements which, while not necessarily improper, had not been helpful, such as that by Aubrey Jones of the British Prices and Incomes Board to the effect that if Britain's restrictive measures were inadequate he could foresee a second devaluation of sterling together with a devaluation of the dollar within 18 to 24 months. If the distrust of sterling, much of which seemed to have an irrational basis, was to be overcome it would not be by words, but by actions following through on the measures announced simultaneously with the devaluation. Some question had been raised in connection with the discussions of the International Monetary Fund standby credit for the British as to whether the planned cutback of government spending was sufficient.

> By unanimous vote, the System open market transactions in foreign currencies during the period November 27 through December 11, 1967, were approved, ratified, and confirmed.

Chairman Martin then invited Mr. Hayes to report on the developments at the meeting held over the weekend in Basle.

Mr. Hayes said he might comment first on the attitudes at Basle with respect to sterling, although that was not the main

subject of discussion at the meeting. A good deal of uneasiness and skepticism about sterling was evident, some of which originated in the attitude of the Bank of England people themselves. The latter seemed rather discouraged and dubious about the probable effectiveness of the measures announced at the time of the devaluation. Governor O'Brien said that those measures were not sufficient and that the Bank of England would press for additional measures. That comment did not add to the confidence regarding Britain's determination to do what was necessary.

With respect to the weekend in general, Mr. Hayes continued, as the Committee knew it had been agreed at the time of the meeting in Frankfurt near the end of November that the same group would reassemble in one week to continue its discussion of the gold pool. However, in light of the calmer situation in the gold market it was decided to defer the meeting for another week, until the time of the regularly scheduled Basle meeting. Under Secretary Deming, who had led the U.S. delegation to Frankfurt, made the necessary arrangements, and the group met with him in Basle yesterday. Meanwhile, representatives of the countries in the gold pool met in Washington last week to make a preliminary review of possible additional measures to keep the gold market situation under control. Not unexpectedly, the gold pool also was the main topic of conversation at the regular Basle meeting on Saturday and Sunday, and it was

discussed in detail by the governors on Sunday evening, at a session which he and Mr. Daane had attended.

On Friday, Mr. Hayes observed, the subject of the gold pool had been discussed by representatives of the six Common Market countries. He was not sure of the extent to which the French took part; presumably, they were at least informed and perhaps they listened to the discussion. It was the tentative conclusion of the Six that it would be desirable to move toward greater restriction on demands in the London gold market. The Six were also thinking tentatively of a temporary suspension of trading in the London market in the event of another flare-up of demand, such as had occurred in the week following the devaluation of sterling. The possibility of such a suspension had been discussed at the Frankfurt meeting, but the proposal had been rejected then following strong objections by the Swiss, who thought such a course would be mistaken. The question was not pursued at the Basle meeting over the weekend, perhaps because of second thoughts concerning the wisdom of a suspension of trading. It was still possible, however, that it remained in the thinking of some of the governors.

Mr. Hayes went on to say that the Common Market governors had also considered the "gold certificate" plan, a summary of which had been distributed to Committee members following the preceding meeting. Their views were not unanimous; in particular, the Germans

were more favorably disposed toward it than the others. The Six had concluded, however, that the opposition to the plan of some of the Common Market countries was so strong that there was no point in pursuing the matter at the weekend meeting of the governors. One objection was that the plan called for the announcement that a specific volume of gold would be made available to the proposed Gold Pool Certificate Fund to keep the price in the London market under control. It was felt that such an announcement would be less effective than a statement similar to that made in the Frankfurt communique to the effect that the aggregate gold and foreign exchange reserves of participating countries were available for the purpose. Also questioned was the proposal that the United States give a gold value guarantee on the Certificate Fund's dollar holdings, on the grounds that such a guarantee might throw a shadow on the large existing holdings of dollars. A significant drawback in the minds of some was that the plan appeared to provide a means for the United States to settle its deficit without making a drawing on the IMF, which they would prefer. Perhaps the most fundamental objection, however, was that while the plan was intended to make participation in the gold pool more palatable by offering central banks something better than dollars for their gold, most of the banks were reluctant to give up gold on any basis.

At the meeting on Sunday evening, Mr. Hayes continued, the chairman of the group asked whether it was generally agreed that

there should be restraints on access to the London gold market. Mr. Daane emphasized the distinction between such restraints on the London market and general limitations on gold dealings of the type the Swiss National Bank had imposed in Switzerland. He (Mr. Hayes) would add, however, that there was no reason why the two types of controls could not be combined. Mr. Daane made a strong effort to get a commitment from the governors that market demands would be met, whatever their level, before the group turned to considering possible means for limiting demands. It was not possible, however, to get such a commitment because some countries, particularly Italy and Belgium, were not prepared to stay in the gold pool indefinitely if that would mean continued substantial gold losses. There was agreement, however, that some program of restraints on demand, particularly in the London market, should be worked out; in the meantime, all of the participating countries were willing to stay in the pool. At the same time, there were differences of approach with respect to details. In particular, the British were concerned that limitations on access to the London market, by diverting demand elsewhere, would work to the detriment of that market which for the past 13 years had been the world's principal market for gold.

There was a real sense of urgency in the discussions, Mr. Hayes said. The governors agreed that a group of technical experts should meet on Monday morning, in advance of the meeting scheduled

that day with Mr. Deming, to discuss the problems and possible methods of limiting demand in the London market and to consider the relationship between the restraints in that market and the kinds of limitations the Swiss National Bank had applied. The Italians and Belgians favored a plan in which a distinction would be drawn between legitimate industrial demands and all other types of demand, with only the former to be met on the London market. It was the general sense that it would be desirable for central bank demands, other than those from the sterling area, to come directly to the United States rather than being permitted to contribute to the pressures in the London market. It was clear that there were many kinds of problems to be dealt with.

Mr. Hayes noted that the sense of urgency at the meeting was greatly accentuated by the problem of leaks. Practically all of the discussion, in garbled form, was published daily in the Paris newspaper Le Monde and those reports were picked up by other newspapers. There were reporters sitting about and waiting in the corridors, something he had never seen before at a Basle meeting.

The discussion then moved on, Mr. Hayes remarked, to the subject of the large accumulation of dollars in European central banks resulting from the operations of the gold pool and, more generally, from the U.S. balance of payments deficit. There was a definite feeling that steps beyond System drawings on its swap

lines were needed to absorb those dollar inflows. In particular, there were strong representations to the effect that the United States should make an IMF drawing soon to fund some of the accumulation.

On the whole, Mr. Hayes observed, attitudes with respect to the situation of the United States were more uneasy and more discouraged than at any time in his experience. There was a growing sense of disenchantment. Mr. Blessing of the German Federal Bank, one of this country's most loyal friends in Europe, said that if the deficit in the U.S. balance of payments remained large the group's discussions might as well be brought to an end because they would be futile. The concern extended to U.S. fiscal policy; the lack of Congressional action on the tax bill was raising questions in the minds of the European monetary authorities as to the willingness of the United States to come to grips with its problems. Less emphasis was placed on monetary policy. Although there was some comment regarding excessive ease in U.S. monetary policy, the fiscal policy area was considered of primary importance.

In connection with the U.S. balance of payments, Mr. Hayes continued, there was strong feeling on the part of some of the governors--as there had been for some time--that the United States should take measures to check the heavy flow of direct investments to Europe. Some of the governors suggested that perhaps European

countries should help by putting restrictions on such inflows to their countries, but the general attitude was that the problem was mainly one for the United States to resolve. It was admitted by some, notably the Belgians and Dutch, that it might be politically difficult for their governments to impede American investment in their countries because of its local popularity. His (Mr. Hayes') own feeling was that the United States should take measures to attack the situation. Another concern--although less intense and not unanimously shared--related to the heavy borrowing of U.S. banks in the Euro-dollar market.

In reply to a question by Mr. Mitchell, Mr. Hayes said that Governor Brunet of the Bank of France had been invited to the Sunday night dinner given by the BIS, but had not attended because of illness.[1/]

1/ Four sentences have been deleted at this point for one of the reasons cited in the preface. The sentences reported further comments by Mr. Hayes with regard to French participation in discussions of the London gold market.

In reply to a question by Mr. Mitchell, Mr. Solomon briefly outlined the policy position on gold the U.S. delegation had in mind when it left the country to attend yesterday's meeting in Basle.

In reply to questions by Messrs. Wayne and Hickman, Mr. Hayes said the whole emphasis of the discussion in Basle of the United States situation was that action by this country was required first, to adopt appropriate fiscal and monetary policies, and second, to limit U.S. direct investment in Europe. He personally agreed with the group's view on both points. The possibility of limiting U.S. tourism had not been raised but he thought that possibility should be studied carefully.

Mr. Brimmer said he understood that Mr. Coombs had developed a plan designed to limit industrial demands for gold by taxing such purchases. He asked whether that plan had been discussed at Basle.

Mr. Hayes replied that the proposal for such a tax had never been acceptable to the U.S. Government and therefore had not been put forward at Basle. In essence, Mr. Coombs felt that a tax would be a useful adjunct to other steps undertaken to limit demand;

that it would automatically reduce demand to some degree, and would result in greater assurance that South African gold would continue to come to the London market. He (Mr. Hayes) was not sure Mr. Coombs was right in his judgment; personally, he thought it might be preferable to restrict demand without introducing taxes or differential prices.

Mr. Brimmer asked whether Mr. Hayes had any suggestions for proposals that the Federal Reserve might make to the Treasury in its advisory role.

Mr. Hayes said that the situation at present was in a state of flux, and one's ideas were necessarily influenced by considerations of feasibility in light of the attitudes taken by other countries. He would hope that as a result of yesterday's meeting of technicians a clearer idea might emerge as to whether there was some workable combination of methods for limiting the demand for gold. To his knowledge no attempt had been made to develop an official System position on the matter.

Mr. Brimmer then said that the press reports of the discussions at Basle over the weekend led him to question the appropriateness of that forum for discussions of means for dealing with the gold problem. He asked whether Mr. Hayes considered the Basle meetings, which traditionally were meetings of central bankers, to be a proper forum for discussion of a matter that was a responsibility of governments as well as central banks.

Mr. Hayes replied that the question was a complicated one. Governmental structures differed among countries, and the United States was almost unique in assigning to the Treasury sole responsibility for external matters involving gold. In many countries the central banks had primary responsibility in that area, although they often were required to consult with their governments. Moreover, central bankers commonly felt that they had greater knowledge and understanding of the practicalities of gold markets than did officials of their governments. Accordingly, it was probably the view in most countries that a meeting of central bank governors was the most appropriate forum for discussions of the type in question. The governors recognized, of course, that in the United States the Treasury had central responsibility with respect to gold, and accordingly they were willing to meet with Mr. Deming yesterday.

Chairman Martin then asked whether Mr. MacLaury had any recommendations to lay before the Committee.

Mr. MacLaury said he would first report that, as had been authorized by the Committee, the maturity dates of all of the System's swap arrangements had now been shifted to the month of December. Four arrangements would mature in the last few days of December. These were the $750 million arrangement with the Bank of Canada, maturing December 28; the $750 million arrangement

with the Bank of Italy, maturing December 29; the $225 million arrangement with the Netherlands Bank, maturing December 29; and the $100 million arrangement with the Bank of France, maturing December 29. The Canadian and Italian arrangements had terms of twelve months, and while the Dutch arrangement now had a term of six months, he understood the Netherlands Bank was prepared to change the term to one year. He recommended renewal of those three arrangements for twelve months.

> Renewal for further periods of twelve months of the $750 million swap arrangements with the Bank of Canada, maturing December 28, 1967, and with the Bank of Italy, maturing December 29, 1967, was approved.
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> Renewal for a period of twelve months of the $225 million swap arrangement with the Netherlands Bank, maturing December 29, 1967, was approved.

Mr. MacLaury noted that the swap arrangement with the Bank of France now had a term of three months. He had no indication at this time of their attitude toward renewal, but he would assume that they would prefer to renew for three months. On past occasions the Committee had discussed the desirability of continuing the arrangement with the Bank of France, and he was not sure what recommendations Mr. Coombs would have made regarding it had he been present at the meeting today. There were various possible approaches to the question including that of following past

procedure. Under that procedure, the New York Bank would send the customary cable to the Bank of France, suggesting renewal for a further period equivalent to the present period of three months.

In the course of the ensuing discussion Mr. Wayne suggested that there might be advantages in leaving the initiative on the matter of renewal to the Bank of France. At the conclusion of discussion, however, it was agreed that the usual procedure should be followed, with a routine suggestion for renewal for the present term to be made by the New York Bank. It was noted that if the Bank of France made any different proposal the matter would be brought back to the Committee.

> Renewal for a period of three months of the $100 million swap arrangement with the Bank of France, maturing December 29, 1967, was approved.

Mr. MacLaury then reported that a number of System drawings on its swap lines would mature in January. These included two drawings on the National Bank of Belgium, of $5 million and $12 million, maturing January 3 and January 16, 1968, respectively; a $100 million drawing on the Bank of Italy, maturing January 17; and a $10 million drawing on the Netherlands Bank, maturing January 18. He recommended renewal of those drawings if necessary, noting that each would be a first renewal.

> Renewal of the drawings on the National Bank of Belgium, the Bank of Italy, and the Netherlands Bank was noted without objection.

Mr. MacLaury noted that two System drawings in Swiss francs, both of which had been renewed once, would mature January 3, 1968. Of these, one was a $33 million drawing on the Swiss National Bank and one a $15 million drawing on the BIS. As he had indicated earlier, means were being worked out to fund the drawings in question if they should prove irreversible. Those means, which would also be employed if necessary to fund the drawings on the central banks of Belgium, Italy, and the Netherlands, probably would include some combination of sales of gold, a drawing on the IMF, and issuance of foreign currency bonds. In the interim, he would recommend second renewals of the two Swiss franc drawings.

Mr. Mitchell asked whether his understanding was correct that if renewed the drawings were not likely to remain outstanding for their full term, and Mr. MacLaury replied affirmatively.

Renewal of the drawings on the Swiss National Bank and the Bank for International Settlements was noted without objection.

In conclusion, Mr. MacLaury reported that two drawings by the Bank of England, for $50 million and $100 million, would mature January 15 and 16, 1968, respectively. He recommended their renewal, if requested by the Bank of England. Both would be first renewals.

Renewal of the drawings by the Bank of England was noted without objection.

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 November 27 through December 11, 1967. A copy of the report has been placed in the files of the Committee.

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

> The close interrelationships between the foreign exchange and gold markets and domestic open market operations have been more than amply demonstrated since devaluation. The reserve supply has been sharply affected by various swap drawings and repayments and by the decline in the gold stock, the Treasury's balance has been subject to wide swings as special certificates of indebtedness have been issued to and redeemed by foreign central banks, and there have been massive purchases and sales of Treasury bills by foreign accounts. While the volatility and scale of foreign operations have made it difficult to conduct open market operations on anything but a hand-to-mouth basis, there have been no insuperable problems and money market conditions have been reasonably stable since the Committee last met. The willingness and ability of the Treasury to permit wide swings in its balance at the Reserve Banks have been very helpful in offsetting the reserve impact of foreign operations.
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> I shall not go into detail, but the Committee may be interested in some summary data on the domestic impact of foreign operations. Since devaluation, the Treasury has issued gross over $1.7 billion of special certificates to foreign central banks and redeemed $1.1 billion; Treasury bill transactions for central banks have totaled nearly $3 billion, about equally divided between purchases and sales; and foreign currency swaps have supplied $900 million gross in reserves to the banking system while repayments absorbed over $600 million. The decline in the gold stock on December 5, of course, also absorbed $475 million in reserves. While there may be some respite from this pace of

activity, I strongly suspect that international operations will continue to exert a considerable influence on our domestic markets and on the reserve situation for some time to come.

Most interest rates have moved higher since the Committee last met--mainly because of disappointment over lack of action on the tax bill and the resulting strengthening of convictions that monetary policy will be tightened. Nevertheless, despite some bad moments, the capital markets turned in a surprisingly good performance. Yields on corporate and municipal securities moved into new high ground, but at those levels investment demand was forthcoming. There was also a surprising demand for Treasury notes and bonds, and with the market in a strong technical position, yields on intermediate- and long-term Government securities closed the period below their mid-November high points.

Most short-term rates also moved higher over the period, although the 3-month Treasury bill held quite steady. Rates on bankers' acceptances, commercial paper, and CD's were all increased, with 5-1/2 per cent available on CD's maturing in as little as 30 days. In yesterday's Treasury bill auction average interest rates of 4.94 and 5.49 per cent were established for 3- and 6-month bills, respectively, about 2 and 3 basis points below rates established on the day the Committee last met.

Looking to the future, the corporate bond market will have at least a temporary respite for the next several weeks. The Treasury will most likely be out of the market until early January when it should be offering about $2 billion or more of tax bills. Whether sales of participation certificates can reach the $4 billion mark budgeted for the remainder of the fiscal year remains to be seen, but another substantial offering should be made by the Federal National Mortgage Association around the turn of the year. Incidentally, the last participation certificate issue--offered on the day the Committee last met--was enthusiastically received at yields of 6.35 per cent for the 26-month issue and of 6.40 per cent for the 20-year issue.

While problems of Government financing will soon be with us again, the more immediate area of market interest lies in the efforts that banks will be making to roll over their heavy December CD maturities and the pressure

that year-end window dressing may bring. The current level of CD rates reflects the banks' concern over their ability to hold their own against market rates, and their uncertainty about the Euro-dollar market. We shall probably have to wait until January to see how U.S. banks fare in the Euro-dollar market; so far they have not been badly hit, rolling over maturities into short-dated deposits.

I have little to add to the blue book[1/] comments about the kinds of money market conditions and reserve aggregates that might be associated with a continuation of current monetary and credit policy or with the alternative of a somewhat firmer policy. The market has, I believe, already discounted some firming by the System. Interest rate reactions to actual evidences of firming--if that is the course the Committee determines--are, as usual, hard to predict, and as the blue book notes, much will depend on market attitudes about the likely future mix of monetary and fiscal policies.

Needless to say, our balance of payments and international developments generally will continue to be major factors shaping domestic financial markets. They will also continue to make--along with uncertainty about the Treasury's balance in the coming week--the task of our reserve projectors an even more hazardous occupation than it normally is. Given the hazy reserve outlook it is hard to say much about the likely course of open market operations for the next several weeks. Current projections would indicate a need to absorb a substantial amount of reserves in the coming statement week and then to supply reserves for the remainder of the year. Much of the reserve bulge currently being projected for next week could, however, disappear if the Treasury is able to maintain its balance at near normal levels.

In response to questions by Mr. Mitchell, Mr. Holmes said he thought a further rise of perhaps 1/8 or 1/4 of a percentage point in short-term interest rates probably would be compatible with maintenance of the current Regulation Q ceilings, although

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

rate increases of that magnitude might generate pressures for an increase in the ceilings. Whether banks would actually maintain their CD volume with such a rate rise would depend on how aggressive they were; if they did fairly well in the Euro-dollar market they might take a relatively moderate approach to the domestic CD market. He would guess that the June tax bills the Treasury was expected to issue in January would have an interest rate somewhat below 5-1/2 per cent, allowing for the value of the tax-and-loan-account privilege. Many banks had built up their holdings of Treasury bills recently, and presumably could obtain funds, if necessary, by the sale of those securities.

In reply to questions by Messrs. Maisel and Swan, Mr. Holmes said that tax bills issued in January undoubtedly would be initially underwritten by banks. The Treasury probably would have to raise a total of up to $7 billion of new money in the first quarter as a whole, although the amount would depend on the volume of PC's sold. No decisions had been made regarding financing operations beyond the tax bills. It was possible that the Treasury would decide to meet its February needs for cash by selling more than $2 billion of tax bills in January, and by raising cash in the February refunding.

Mr. Brimmer noted that the projections suggested a need to supply reserves in the latter part of December, and that there was

some rough indication of a need to absorb close to $800 million of reserves in January. He asked what type of operations the Manager would contemplate undertaking in the period before the end of the year if the Committee adopted alternative B of the draft directives submitted by the staff,[1/] which called for somewhat firmer money market conditions.

Mr. Holmes said the question was difficult to answer because the projections were so uncertain at this stage as to be almost worthless as forecasts of actual reserve conditions. They were useful mainly in providing a set of numbers that could be modified as time passed and uncertainties were resolved. The decisions with respect to open market operations would have to be made from day to day in light of developments.

> By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period November 27 through December 11, 1967, were approved, ratified, and confirmed.

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

Mr. Brill presented the following statement on economic conditions:

1/ Appended to this memorandum as Attachment A.

Evidence of resurgence in economic activity is cumulating. The fragmentary data we had available to report at the last meeting of this Committee suggested that, with the termination of major strikes, industrial production in November would show a recovery of about 1 index point. The additional data now available on employment and hours of work--strictly confidential until release tomorrow by the B.L.S.--indicate a significantly greater rebound. Employment in manufacturing rose sharply--much more than can be accounted for solely by the return of strikers to production lines--and hours of work increased significantly. At the moment, therefore, we are estimating that the November production index will be up by over 2 index points, to within 1 point of last December's peak. Employment gains were strong outside of manufacturing, too, and the over-all unemployment rate fell back to below 4 per cent.

Along with these indications of revival in business activity come preliminary signs of consumer loosening of the pursestrings. The advance retail sales estimates for November show renewed strength in consumer buying in almost all commodity areas, except for autos where supply limitations were still operative. With the resurgence in production and sales, with the GM strike postponed at least until after year-end, and with retroactive pay checks expected to be in the hands of Government workers before Christmas, the fourth-quarter rise in GNP is going to be large--at least matching, and more probably exceeding, the rise in the third quarter.

Furthermore, the odds are strongly on the side of further acceleration into early 1968. The results of the latest survey of business plans to spend for new plant and equipment, although puzzling in a number of respects, can't be talked away completely, as some die-hard pessimists have tried to do. Granted that recent and current capital spending are falling short of earlier business plans, it's dangerous to project continuing shortfalls, given that activity is on the rise, capacity utilization will be trending up and cost pressures still mounting. And granted that the increase in spending plans is unusually concentrated in a few industries, instead of being a broad-based investment boom, a dollar of expenditure by a public utility is as expansionary as any other dollar of capital outlay. Fulfillment of reported spending plans would add from

$2 to $3 billion more in final demands over the first half of next year than we had been led to expect from earlier private surveys. Prospective strength of consumer spending increases the possibility that business investment demand may become more widespread.

In assessing consumer demand, we have not projected a decline in the savings rate. We don't know why the rate has held as high as it has as long as it has but, as we pointed out last winter, extended periods of high savings rates are not unprecedented. Indeed, with all the income that will be generated by exogenous forces over the next few months, we can only pray that our hesitant projection is right and that consumers continue to behave soberly. A full-scale GM strike seems less likely now, suggesting less disruption to the strong untrend in personal incomes. The collapse of tentative plans for an early steel contract settlement suggests a continued high and rising pace of output and employment in the steel industry. Increases in social security benefits, almost in the magnitude we have been assuming but coming in sooner rather than later, and the minimum wage increase, still on the books for February 1, will be augmenting regular income flows. Moreover, the full impact of the Federal pay raise will be felt on the economy by early 1968. Thus, even with a continued historically-high savings rate, consumption expenditure should rise substantially.

Stronger consumer markets will also be an incentive to additional inventory building by business, a process already stimulated by renewed strike prospects in steel and by improved prospects for maintaining auto production. And construction expenditures will hold up for a while, at least, given the recent rise in housing starts and the large volume of mortgage commitments outstanding.

Pitted against this prospective strength in the private economy is half of a proposed program of fiscal restraint. There can be little doubt that over the next two quarters the hold-down on Federal spending will be real. It has been promised, and the wheels set in motion to achieve it, whether or not the tax increase is passed. With revenues rising from the upsurge in incomes, the Federal deficit on a national accounts basis should drop substantially. Unfortunately, it will still be a deficit, whereas in a fully employed economy in which the GNP price deflator is rising at an annual rate of close to 4 per cent, we should be running a surplus on a national income accounts basis.

If rigorous control over Federal spending is extended into fiscal 1969, and if present levels of credit costs bite more deeply into consumer and business spending plans as the year progresses, there is a danger of economic weakness emerging later in 1968, a danger which a belated tax increase--say, by April--would magnify. In assessing the possibility of a second-half slowdown, one must, of course, recognize the forecaster's well-known syndrome, namely, the inability to see a dollar of GNP demand six months ahead.

But even if prospects truly are for a weaker second half, we won't be helping to strengthen the outlook by permitting inflation to accelerate this winter. This is one occasion on which I am willing to shorten the time horizon for policy, in order to curb, to the extent possible, business enthusiasm for rebuilding inventories. Concern over the second-half outlook could prove a useful contra-cyclical weapon. And we need some weapon. The paralysis in Government policy in the face of price and wage pressures is giving countenance and encouragement to even more rapid increases that can do lasting damage to the stability of domestic growth and to the protection of our international trading position. We have a pertinent example in the round of price increases on important steel products long in advance of wage contract negotiations, which will stimulate higher steel imports and at the same time provide the domestic auto industry with another reason to raise prices again, for which there will be a convenient occasion shortly.

My concern over this cumulating of price pressures is not only with the confidence of other central bankers in the wisdom of U.S. economic policy, important as this may be in the short run, and particularly on the heels of a currency devaluation in another country which did not seem able to find the right trade-off between economic expansion and reasonable cost and price stability. My concern is also with the possibility that we are building into our economy a repetition of the 1966-67 experience--or worse, that of the mid-1950's. The failure to achieve adequate fiscal restraint in early 1966 has set into motion economic oscillations that are <u>not</u> being damped, but, on the contrary, threaten to become larger.

The need for restraint has been evident for many, many months. As far back as last June, the staff's analysis suggested that the original tax program of a

6 per cent surcharge might not be adequate to cope with emerging inflationary pressures. But the Administration's proposal for an even more rigorous restraint program has, in my judgment, warranted our policy of allowing financial markets to tighten gradually and borrowing costs to advance as the year progressed, while avoiding constriction of bank credit flows during periods of intensive Federal demands on financial markets.

Now that the tax part of the fiscal program is unlikely of passage, however, we have to reassess this course of allowing markets to tighten themselves in the face of soaring credit demands, and decide whether to nudge interest costs further. The critical policy question, at the moment, is whether the level of borrowing costs has become high enough, and whether the projected slowing down in credit expansion rates is rapid enough, to achieve some moderation in private spending plans in reasonably timely fashion. This is a closely balanced matter to judge. My colleague, Mr. Partee, thinks this may be the case. I am not convinced. As I see it, the economy needs a clearer and stronger signal of restraint than merely embedding the recent discount rate increase into the interest rate structure. But I would caution that by next week, when the full scope of buoyant November statistics is known to the public, and Congress has already recessed without having taken action on taxes, market rates could push even higher. I would urge not resisting such a market move, so long as it was moderate and orderly; indeed, if it doesn't materialize on its own, I would recommend initiating it.

Mr. Mitchell asked whether Mr. Brill expected that the economy would be fully employed by, say, April 1968.

Mr. Brill replied that he thought a situation approximating full employment had already been attained. He noted that the unemployment rate had declined to 3.9 per cent in November. Recent estimates suggested that over an extended period of steady increases in real GNP of about 4 per cent, full employment would be reflected in an unemployment rate of about 3-3/4 per cent. Growth recently

had been far from steady, but real GNP was rising at a rate considerably higher than 4 per cent in the second half of 1967, and further acceleration was expected in early 1968.

Mr. Mitchell noted that manufacturing capacity currently was being utilized at a rate below 85 per cent and that industrial production had not yet reattained its level of a year earlier. He asked whether Mr. Brill would attach any importance to those facts in deciding whether the economy was now fully employed.

Mr. Brill said he would consider the current rate of capacity use relevant at this point in time if it appeared to be deterring advances in industrial prices. But the record indicated that it was not having that effect or, as was more likely the case, that it was less influential on price decisions than were the rising costs and reviving markets. As to the level of industrial production, the underlying strength of demands for output had been masked in recent months by a series of strikes, and rapid growth in output was now resuming.

Mr. Mitchell then referred to Mr. Brill's suggestion that monetary policy could curb the enthusiasm of business for rebuilding inventories, and asked about the channels through which he thought that result might be accomplished.

Mr. Brill replied that one such channel was, of course, the cost of borrowed funds, although he was not sure that the

relations between interest rates and business spending often found in longer-term econometric studies would apply in the coming period. Another important channel--on which he would not want to rely exclusively--was expectations. If businessmen became convinced that the Federal Reserve was willing to risk a slowdown in activity in the second half of 1968 in order to curb inflationary pressures, they presumably would conclude that it was desirable to moderate the pace of their expenditures on inventories and on plant and equipment. On the other hand, if it became clear that there was little promise of the necessary restraint from either fiscal or monetary policy, businessmen would feel justified in increasing their planned spending. He did not think it was feasible to stop the advance of prices in the short run through monetary policy, but in his judgment it would be desirable to make businessmen cognizant of the fact that exuberant spending plans would not be supported by monetary policy.

Mr. Brimmer referred to Mr. Brill's comment that higher costs of borrowing would help curb spending, and asked whether reducing the availability of bank credit by increasing member bank reserve requirements might not be a desirable alternative means of accomplishing that end. He recognized that it was not possible to distinguish completely between cost and availability. Still, business inventory accumulation and consumer spending on

durable goods were likely to be the main sources of economic stimulus in the early part of 1968, and it was possible that they could be moderated more effectively by increasing reserve requirements than by initiating open market operations for the purpose of raising interest rates.

Mr. Brill observed that higher interest rates might result either from restrictive open market operations or from forces generated by the market itself. In the former case member bank reserves, and hence credit availability, would of course be affected. He agreed, however, that an increase in reserve requirements would be more visible, and would attract more public attention than, say, a series of declining marginal reserve figures resulting from restrictive open market operations.

Mr. Galusha noted that a major factor underlying various projections of slackening economic growth in the second half of 1968 seemed to be an anticipated slowdown in Federal expenditures. He asked whether that was Mr. Brill's impression, and if so how creditable he thought the expectations of a slowdown in Federal spending were.

Mr. Brill replied that most of the projections of economic activity in the second half that he had seen implied slowdowns in both Federal spending and housing activity. He had talked with various people in the Budget Bureau in an effort to asses such

expectations for Government spending. It seemed clear that the Administration was determined to keep spending down in the fiscal year ending June 30 by eliminating or deferring planned expenditures. However, it was too early to get a clear picture of the extent to which a continuing hold-down would be feasible in the second half of calendar 1968. There had been differences of view on the subject at an inter-agency meeting last week, and he did not know how those differences would be resolved.

Mr. Mitchell agreed that there was a concerted effort under way to hold down Government spending in the first half of 1968. It was quite possible, however, that those efforts would be reversed in the second half of the year.

Mr. Hickman remarked that from conversations with bankers in his District he had the impression that the current relative ease in the money market was causing banks to make business loan commitments for inventory and other purposes for next year, when an increase in business loan demands might be expected in any case. Presumably such a tendency would be discouraged by a shift toward a firmer open market policy. He asked whether the staff had any information on the volume of such commitments.

Mr. Partee said he had heard similar reports, but had no quantitative information on the subject. The interest of businesses in such commitments was usually attributed to a desire on their

part to assure the availability of funds next spring, when they expected that monetary policy would be tighter.

Mr. Partee then made the following statement regarding financial developments:

> The buoyant economic outlook, as outlined by Mr. Brill, would seem clearly to call for stronger measures of official restraint in the period ahead. In the absence of a large fiscal package, perhaps considerations of public policy do now require a compensatory adjustment towards further restraint in the monetary area. Current international financial relationships, to be discussed next by Mr. Solomon, also indicate the desirability of tautness in domestic financial markets, in terms of financial flows as well as interest rate levels, as an aid in improving some aspects of our balance of payments situation. Perhaps these considerations will be judged compelling by the Committee in its deliberations today. But I would be derelict if I did not voice my reservations, based on an analysis of current and prospective financial developments, concerning any move toward significantly firmer money market conditions at this time.
>
> My arguments against a further tightening now are three in number. First, I would remind you that the level of interest rates in long-term debt markets is already very high, and that this should be serving to moderate marginal and postponable spending and financing plans throughout the economy, both currently and into the future. Second, I would point out that expansion in the banking aggregates has slowed appreciably in recent weeks, and that a continuation of present rate relationships suggests that growth in the demand for deposits is likely to continue slower than before, on average, in the months ahead. And third, I would caution that even moderately higher market rates, particularly in the 1- to 5-year maturity area, could risk substantial dislocations in the flows of funds through banks and other savings intermediaries versus the market, with seriously adverse implications for some debt markets and perhaps even for the viability of some individual institutions.

Everyone here is well aware that long-term rates are currently the highest for this country in living memory. But the real question is how much restraint is being generated by these levels of yields. I believe that it is considerable, and that this is likely to be showing up increasingly in financing and spending plans. In the bond markets, there have been numerous recent postponements and cancellations, and the ominous sense of the market that many prospective issuers are waiting in the wings seems to have diminished markedly. Some municipal issuers have been deterred by interest rate ceilings, and others are probably becoming concerned about the tenability of earlier profits projections for new and expanded revenue projects. Discounts on FHA mortgages in the secondary market now average over 6 points--cutting directly into the seller's equity or the builder's profit--and substantial discounts are also required on conventional mortgages in those states with 6 per cent usury ceilings. Mortgage yields generally are still adjusting to the more rapid increase in other markets, so that higher rates--or larger discounts--are clearly in store.

It is often argued that present interest rates include an inflationary premium, and hence that they are not so restrictive as they may seem. To the extent that there is such an effect, it must operate mainly through the willingness of borrowers to pay higher rates in order to avoid delays and consequent cost increases in projects planned. But what are the magnitudes of the alternative costs? Interest rates in some long-term markets are now 50 basis points or more higher than at the previous peaks reached in the second half of 1966. The present value of a 1/2 per cent difference in yield amounts to 5 points on a long-term amortizing loan, and to about 6 points on a 25-year non-amortizing bond. Put another way, if a borrower believes that interest rates will drop one-half point over the next year or so, the potential cost saving involved would offset a price increase in the interim of 5 to 6 per cent in the purchase planned. Inflationary expectations have intensified since 1966, but I doubt that they have increased to this extent. Therefore, I would judge present interest rate levels to be basically as restraining in effect--if not more so--as at the previous peak.

The availability, as distinct from the cost, of credit remains much better than in 1966, however, and in

view of the inflationary outlook it may be appropriate to seek a sizable curtailment in the flow of funds through banks and other savings depositaries. But it should be recognized that this process has already begun and that, given the present structure of interest rates, marginal shifts in funds flows away from the institutions may well increase in the weeks ahead. Bank time deposits other than negotiable CD's have been growing less rapidly than during the spring and summer, as have balances in the specialized savings institutions. And although large CD's have increased further recently, banks have had to raise offering rates to the ceiling on maturities as short as 60 to 75 days in order to attract the funds.

We are now approaching the turbulent year-end period in CD and savings markets. Rate comparisons seem still to be marginally favorable to CD's in the shorter maturities and, although the rates on market instruments are positively attractive to savers, the rate ceilings in effect should serve to hold down inter-institutional competition. The most likely prospect, therefore, is that massive transfers will be avoided, but that net inflows to the institutions will drop off further. If so, this will tend to tighten the availability of credit from banks and other depositaries, with the degree of tightening depending on the extent of the drop in deposit inflows. Liquidity positions are considerably improved all around, comparing favorably with two years ago, but the institutions are likely to draw on these resources only with great reluctance in view of the uncertainties of their situation.

The pace of aggregate bank credit expansion has been much slower in recent weeks, despite rapid CD growth, and is expected to continue slow in December. Thus, the credit proxy grew at only a 3 per cent annual rate from the beginning to the end of November, and growth will probably continue at about this same rate in the current month. The slower growth is mainly due to a reduced volume of Treasury financing, of course, and will be reversed temporarily in January. More generally, however, it seems reasonable to expect a continuation of more moderate bank credit expansion on average over coming months if present interest rate relationships persist. Banks probably will be unable to attract either corporate or consumer time deposit funds in the volume of recent months, and the demand for money balances may also recede

from the unusual 7 per cent expansion rate that has prevailed this year. A slowing in money growth to a rate more in accord with transactions needs should accompany any decline in uncertainty, especially if holders of idle balances come to have more confidence in prevailing market prices for cash substitutes and other securities.

Now I do not want to argue that a slight firming up of money market conditions, including free reserves, would necessarily upset the delicate balance of all these rate and flow relationships, particularly if it were accomplished gradually. There is a good deal of looseness in the linkages, as reflected in the fact, for example, that long-term Government and corporate yields did not change appreciably on balance over the last 3 eventful weeks. But there is some risk of upset if any policy tightening move should be large enough to influence expectations materially.

The higher configuration of rates already achieved, I believe, will significantly moderate funds flows to the banks and other intermediaries in the period ahead. But if market rates rise much further the desired restructuring of financial flows could be overdone. This would necessitate reconsideration of Regulation Q and related interest ceilings, which in turn could bring a subsequent escalation in the whole structure of rates--an escalation that I do not believe to be required for domestic stabilization purposes. I would much prefer to see the complex of market conditions held broadly unchanged for a while, until we can get a better fix on the degree of moderation in bank credit expansion and other institutional flows that is already in train.

Mr. Hickman remarked that Mr. Partee's observations on the restraining effects of the rise in interest rates turned on the level of borrowing costs before consideration of income taxes. In his judgment corporations contemplating borrowing were likely to think in terms of after-tax, rather than before-tax, costs. On the former basis the rise in long-term rates from their 1966 highs was roughly half that indicated by Mr. Partee, and if businessmen thought

in after-tax terms the restraining effects of current rate levels would be much smaller.

Mr. Partee said he had considered the implications of income taxes in preparing his comments. It seemed to him that taxes should not be a relevant consideration in a corporation's choice between the alternatives of paying higher interest rates now or paying higher prices for whatever was to be bought later, since those higher prices would also be a tax-deductible expense. Tax considerations would, of course, be relevant in connection with other types of corporate decisions--such as between undertaking equity or bond financing.

Mr. Maisel thought that Mr. Partee's argument was analytically correct. It was possible, however, that some corporate treasurers were myopic on the matter, giving weight to the effects of taxes in partly offsetting current high borrowing costs, but not to the same effects in connection with expected increases in commodity prices.

Chairman Martin observed that while the issue was debatable, he suspected that most corporate treasurers were myopic in the sense Mr. Maisel had indicated.

Mr. Swan noted that the blue book projected growth in the bank credit proxy at an annual rate of 2 to 5 per cent in December if money market conditions were unchanged, and it said that the

expansion rate was "likely to be larger" in January. He asked if Mr. Partee could indicate the approximate magnitude of the probable January growth rate.

Mr. Partee said the main reason for projecting an increase in bank credit growth in January was the expectation that the Treasury's tax-bill borrowing around the middle of that month would initially be financed largely by banks. In the absence of information on how rapidly banks would sell off the tax bills they acquired, it was difficult to say how large would be the rise in bank credit over the month, but it was likely to be considerably larger than in December. Were it not for the Treasury financing, January growth probably would have been projected at about the same rate as shown in the blue book for December.

In reply to a question by Mr. Brimmer, Mr. Partee said that savings and loan associations probably would experience some difficulties as a result of withdrawals of funds after the year-end dividend crediting period. He did not believe the assertion sometimes heard that there no longer was any "hot money" on deposit at S&L's; inflows to the associations had been tremendous this year, and sizable sums might well be subject to reinvestment in attractive market instruments, such as the expected FNMA issue to which Mr. Holmes had referred. While he was not able to estimate the seriousness of those difficulties, they obviously would be

increased if monetary policy was tightened and market interest rates rose further before the year end.

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

> Three weeks have elapsed since the devaluation of sterling. We may take some comfort from the fact that the worst fears have not been realized. Devaluation was confined to a few countries and there has been little speculation against the dollar after the first post-devaluation week.
>
> Nevertheless, there is considerable unease in the financial world regarding 1) the viability of sterling at the new exchange rate, 2) the U.S. balance of payments, and 3) the price of gold both in London and at the U.S. Treasury.
>
> It is possible to separate the gold problem and the U.S. balance of payments problem in the sense that over time one can see the demand for gold rising faster than the supply regardless of the U.S. balance of payments. The agreement on Special Drawing Rights in the IMF offers a long-run solution to this problem.
>
> But there is also an important relationship between the gold problem and the U.S. balance of payments. The persistence--and, apparent worsening--of the payments deficit is no doubt contributing to unease and speculation in the gold market. Those who are taking positions in the gold and foreign exchange markets cannot rule out the possibility that intensified pressure on the U.S. gold stock could lead to either devaluation of the dollar against gold--i.e., an increase in the official price of gold--or to some other drastic measure, such as an embargo on gold sales. Such expectations are undoubtedly strengthened by reports about the poor state of the U.S. balance of payments.
>
> The pressure point where this uneasiness about the dollar reveals itself is the London gold market. What happens in that market reflects many uncertainties--not only about the U.S. balance of payments but questions as to the willingness of the United States and its gold pool partners to continue to feed gold into London.
>
> Whatever steps the gold pool countries may be willing to take with respect to the London market, these measures

do nothing toward reducing the excess of dollar payments from the United States and the accumulation of dollars by foreign central banks that are increasingly likely to convert such dollar accruals into gold at the U.S. Treasury. A further erosion in the U.S. gold stock is, in turn, very likely to stimulate speculation by private gold buyers and to induce central banks that have heretofore been content to hold dollars to change their policies and buy gold from the United States.

In this situation it is pointless to invoke the name of William Jennings Bryan and blame all our troubles on adherence to gold as a monetary standard. Gold is our principal reserve. Neither the United States nor any other country can expect to experience a continuing decrease in its reserves without engendering uncertainty as to the future value of its currency. In fact--because our currency is held as a reserve around the world--we are more vulnerable than others to speculative reactions to reductions in our reserves.

Thus, we face the need to improve the balance of payments--a need that has undoubtedly become much more urgent in the past month.

The outlook for the balance of payments next year is not promising. Given the projections for domestic activity, we must expect imports to rise in the months ahead, hoping, meanwhile, that recovery in Europe will make for an acceleration of our exports. Although some components of the payments balance are likely to improve--for example, foreign security purchases by Americans and tourist expenditures--others may continue to deteriorate--for example, Government loans and credits, reflecting in part Export-Import Bank lending, and military spending abroad.

In these circumstances, it is necessary to take strong measures that not only have a significant near-term effect on the payments balance but appear to the world to be decisive and determined.

What options are open to the United States? The first one is forceful restraint against inflation. In contrast to some past periods, balance of payments and domestic considerations now reinforce each other in pointing to the need for restraint.

Adequate restraint on domestic demand--to minimize the upward movement in prices and to prevent excessive imports--is a necessary condition for improvement in the balance of payments. But even adequate restraint on

demand at home does not guarantee near-term improvement of the needed magnitude.

What else can be done?

It is commonplace to say that a correction of the imbalance in world payments requires action by both European surplus countries and the United States. For unless improvement in the U.S. balance is reflected in reduction in European surpluses, the U.S. improvement would not be sustainable. That proposition is perfectly sound, but it should not be used as an excuse for complete inaction by the United States. What's more, Europeans are understandably offended by the suggestion that it is up to them to adjust to a continued flow of U.S. direct investment to Europe.

The flow of dollars to continental Europe to finance direct investment by American corporations is estimated at almost $1 billion this year. If this outflow were cut to zero, it would not solve the U.S. payments problem, but it would put a sizable dent in it. Beyond that, it would provide a significant demonstration of U.S. willingness to try to reduce the imbalance. We would then have a much stronger case in urging Europe to do its part.

It would be reasonable, therefore, for the President to request American corporations, for the duration of the Vietnam War, to reduce drastically the net flow of capital to continental Europe. The target ought to be as close to zero as it can practically be made. How the corporations achieve the target is up to them--they can reduce their outlays or they can borrow more in Europe. At the same time, they would have to be asked to continue to repatriate earnings from Europe in the same proportion to their total earnings as in the past.

If this action could be coupled with a reduction in military expenditures in Europe, it would be much more acceptable to the corporations and the balance of payments gain would be that much greater. Military expenditures on the continent amount to about $1.4 billion annually, and efforts to achieve an adequate offset have been disappointing.

Another measure that has often been suggested is a reduction in tourist expenditures. Here we run into serious dangers. For one thing, if we were to consider restraining tourism, we would presumably want to exempt the Western Hemisphere, Asia, Africa, and the United

Kingdom. Thus, what is involved is a discriminatory restriction against continental Europe, and we might even want to exempt some continental countries, such as Greece, Turkey, and Yugoslavia. There are two objections. One is that we have resisted restrictions on the current account of the balance of payments. It would be unfortunate to open this Pandora's box. Secondly, we must face the possibility of retaliation in one form or another by continental countries.

In a crisis, however--and we may be close to a crisis--we should consider a patriotic appeal to American citizens to refrain from traveling to the continent for the duration of the Vietnam war.

I have left to the end the problem of most direct concern to this Committee--what monetary policy should do. The balance of payments calls for restraint and if fiscal restraint is inadequate, monetary restraint is in order. There is only one consideration, from the international side, that argues against a significant shift toward greater monetary restraint: sterling is in a very uncertain condition even at its new par value. If sterling were forced off its present parity, the consequences for the international monetary system could be extremely severe.

One could hope that the U.K. authorities would implement devices to insulate London from the pull of higher interest rates abroad. If that happened, tighter money here would not only contribute to restraining aggregate demand; it would attract funds from the continent and, at least temporarily, lessen the build-up of dollars in continental central banks. But as long as sterling remains in precarious condition, I cannot in good conscience recommend a decisive and visible shift toward greater monetary restraint. This does not rule out a mild and gradual movement in that direction.

Mr. Mitchell asked whether Mr. Solomon thought that a drastic cut-back of U.S. investment in Western Europe would change the prognosis for a rise in economic activity there sufficiently to hurt U.S. exports to the countries involved.

Mr. Solomon replied that if instead of borrowing more in Europe American corporations cut their actual investment in plant

and equipment there, U.S. exports undoubtedly would be affected. However, the effect was likely to be small, since U.S. corporations accounted for only one or two per cent of total investment on the continent.

Mr. Hickman asked whether an increase in Regulation Q ceilings on large-denomination CD's in the United States would reduce the pressure on U.S. banks to borrow in the Euro-dollar market.

Mr. Solomon replied affirmatively.

Mr. Maisel asked what effect such an action would have on the U.S. gold drain.

Mr. Solomon replied that insofar as the supply of Euro-dollar funds had been from the United Kingdom, there would be little effect on U.S. gold reserves; insofar as the funds came from the continent, they had been helping appreciably by reducing accumulations of dollars and therefore conversions into gold by continental central banks.

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

> In my view we have reached the point where a more restrictive open market policy is appropriate and necessary. Such a change is needed both because of the domestic outlook and because of international considerations. On the international side, the vulnerability

of the dollar has increased in the wake of sterling devaluation and subsequent developments. While I do not believe that the Federal Reserve can carry the burden of maintaining confidence in the dollar all by itself, it can, and must, make its contribution.

On the domestic side it is still too early to make a firm evaluation of the effects of recent international developments on business and consumer confidence. So far, at least, I believe that these have been very slight. The most likely prospect for 1968 continues to be one of excessive aggregate demand. The unanimity of recent surveys of plant and equipment spending in pointing to a pickup in this sector during 1968 is impressive. But a more important development since our last meeting has been the demise of any hope for a tax increase during this session of Congress. I cannot help feeling that the prospects for a tax increase in early 1968 are at best dubious.

Even aside from the prospects for excessive domestic demand over coming months, price pressures have been highly visible for some time. The consumer price index has risen since last March at an annual rate of over 3-1/2 per cent, and the industrial wholesale price index since July at an annual rate of almost 3 per cent. On top of this, in the past week another outbreak of price increase announcements has occurred--most notably in steel. Accentuation of inflationary pressures and a further growth in inflationary psychology appear to be highly likely if excessive demands are piled on top of pre-existing cost pressures. The growth of inflationary attitudes must be checked both in the interest of longer run domestic stability and because of the adverse effects on international confidence in the stability of the dollar.

As I said earlier, recent developments have clearly increased the vulnerability of the dollar. The decline in the gold stock announced last week has made this dramatically clear. While the gold situation has since improved, this is partly the result of the special measures Mr. MacLaury has discussed. And these, by their very nature, cannot be depended upon as more than a stopgap. There is, of course, some hope that current discussions will lead to a more lasting improvement in the gold market situation. But more fundamentally, the third-quarter balance of payments figures--which show a regular liquidity deficit of $2.7 billion at a seasonally

adjusted annual rate, and an underlying deficit before special transactions of $3.5 billion--do not make pleasant reading. The figures available for October and November point to a further deterioration in the fourth quarter, with an underlying liquidity deficit of perhaps $5 billion. Moreover, it will take some sizable special transactions to offset the effects on the recorded liquidity deficit of British liquidations of Federal agency securities in the fourth quarter. Looking ahead, recent devaluations will have an adverse effect on our balance of payments. In this setting, the development of excessive aggregate demand is particularly dangerous in its implications for higher imports and reduced American competitiveness in world markets.

I suppose we can take a bit of satisfaction from the fact that bank credit growth has moderated to some extent in recent months. However, I would like to make several points. First, an annual growth rate of 8 per cent since August appears moderate only in the context of the 13 per cent growth rate over the first 8 months of the year. Second, part of the slowdown may only reflect the lull in the business expansion associated with strikes. Third, it is very possible that unavoidable deficiencies in seasonal adjustment procedures may have resulted in an understatement of recent growth rates. But even taken at face value, an 8 per cent growth rate is very high, given existing inflationary pressures, prospective increases in aggregate demand, and our bad balance of payments. These figures on credit flows, and related figures on the money supply, are receiving considerable attention in financial circles both at home and abroad. While the size of the Federal budget deficit is considered alarming, figures on money and credit flows are also viewed very critically. The 7 per cent annual rate rise in the narrowly defined money supply experienced thus far this year raises a lot of eyebrows.

There is no escaping the fact that our fiscal situation is in sad disarray. It is all the more important that monetary policy behave responsibly. It seems to me that all the fundamentals call for a more restrictive stance, although I am under no illusion that monetary policy can by itself solve all our domestic and international problems.

During much of the autumn, the System was prevented from moving toward greater restraint by factors which

have now disappeared or become less compelling. The receding hope of tax action is significant, since we have been inclined to refrain from tightening monetary policy for fear that this might have an adverse effect on the Congressional climate for tax legislation. Unfortunately, the climate was bad enough anyway.

The fear of tipping sterling over the devaluation brink was also an inhibiting element. While even now we cannot be unmindful of the effects of our policies on sterling, our most immediate concern must be for the dollar and the preservation of the present international financial system.

Even keel considerations, in connection with Treasury financings, had to be given much weight in recent months. Now, however, there are still a few weeks before late December when such considerations will not be operating. After the turn of the year, we will again face a succession of Treasury operations. Even keel considerations will probably be an important factor inhibiting action throughout the first quarter of 1968, if not beyond.

Any restrictive action that we take should of course be cautious. We must be concerned over sensitive market conditions and over the disintermediation problem. Technically, however, the Government securities market is in quite good shape. The markets are at any rate expecting that something more will be done. As to the disintermediation problem, I think we must face the fact that higher market rates would increase the possibility of pressures on both commercial banks and on thrift institutions. Indeed, as I see it, the whole point of the exercise would be to increase such pressures, both with a view to slowing the rate of growth of bank credit and to damping down the over-stimulated economy that seems to be in prospect.

In the light of all this, I believe we should move toward somewhat tighter conditions in the money market along the lines of the policy alternative outlined in the blue book. I would aim at a Federal funds rate persistently above the discount rate, generally in the 4-5/8 - 4-3/4 per cent range. This would undoubtedly entail a lower level of free reserves, perhaps at $100 million, or as low as zero, and a higher level of member bank borrowings.

As to other instruments of credit policy, I believe that an increase in reserve requirements on demand

deposits would be helpful some time soon, perhaps as a part of the System's contribution to a strengthened balance of payments program. Such a move would demonstrate that we were following up our earlier move on discount rates with action designed to limit reserve and credit availability. Moreover, given the uncertainty about the capital markets, I think it would be well to have the Manager positioned to be on the buy side rather than on the sell side and a reserve requirement increase would do just this. Regardless of whether reserve requirements are raised, my prescription for open market policy remains the same.

I would hold off on any further discount rate action at this time. While I would have preferred a 1 per cent rise last month, now that we have moved by 1/2 per cent I think that no useful purpose would be served by an additional increase at this time. Such a move coming very close on the heels of the other increase might merely create an undesirable impression of indecisiveness and uncertainty. Developments over the coming weeks, especially in the international area, may of course force us to take such action.

As to the directive, alternative B seems highly appropriate.

Mr. Francis commented that total demand for goods and services was currently rising at about a 9 per cent annual rate. That was clearly an excessive pace in view of the current level of production, and of the growth of capacity at about a 4 per cent rate.

Inflation was a reality, Mr. Francis continued. Prices were rising in response to both past and current excessive demands. The pervasive effects of inflation were now spreading through many aspects of the nation's economic life. Over-all prices were now going up at about a 4 per cent annual rate. The price increases were widespread, affecting most industries and services, and were

being announced almost daily. Wage increases were far in excess of productivity gains. Expectations of price rises and increases in costs of resources were likely to cause prices to rise throughout most of next year, even if the rapid pace in spending was moderated.

Inflationary developments were pushing up interest rates, Mr. Francis remarked. Savers and lenders sought to protect the purchasing power of their funds. Borrowers were more willing to borrow when items to be purchased were going up in price and were more willing to pay higher rates when they expected to repay in cheaper dollars. Although market rates were high by past standards, they were still low in a "real" sense and were likely to rise further if inflationary expectations and loan demand increased.

The country's basic balance of payments situation was worsening because of the inflationary situation, Mr. Francis observed. The trade surplus would be further adversely affected both by excessive domestic demands for goods and by accelerating prices. Since early fall, the Committee had delayed making any changes in policy because of the crisis in Britain. That situation, although still unsettled, should not cause the Committee to delay any longer; indeed, the developments unfolding in Britain now should emphasize the need for sound policies in this country.

Mr. Francis remarked that the excessive demands for goods and services and the accompanying rise in interest rates were,

once again, beginning to curtail the availability of funds for mortgage financing. The longer the excessive demands persisted, the more certain it was that a serious "credit crunch" would come. Temporarily pacifying the financial markets by rapid injections of bank reserves, bank credit, and money was no real solution. Continued provision of bank reserves at the recent rapid pace only reinforced the excessive spending and market expectations and induced even more urgent demands for credit.

Unfortunately, Mr. Francis said, vigorous fiscal action to help reduce total spending, huge credit demands, high interest rates, and inflationary pressures had not been forthcoming. Economic stabilization depended on avoiding further excessive monetary expansion. Both domestic needs and the international balance of payments position of the United States called for the same policy prescriptions. Restraint on total spending was essential to relieve financial market pressures, to foster sound economic growth, and to protect the strength of the dollar at home and abroad. Moderate monetary restraint could contribute to achievement of balanced economic expansion.

Mr. Francis commented that some were reluctant to tighten monetary conditions because the effect might impinge on certain activities more than others. Selective credit controls, wage freezes, and price restrictions had been advocated as alternatives.

Such controls, however, restrained particular activities and also raised problems of resource allocation; they interfered with freedom; and they were difficult to administer.

He did not suggest an abrupt change in monetary conditions such as occurred in the spring of 1966, Mr. Francis continued. At that time the money supply, which had been going up at a 6 per cent annual rate, suddenly began to show no growth. His proposal was to seek a firming of the money market sufficient to reduce the growth rate of money from its 7 per cent rate this year to a rate about half that fast over the next few months. Inflationary forces and sentiment were now so strong that it would take many months to reach a sound, sustainable growth without continuous price increases, but the longer the decision to act was postponed, the more difficult the ultimate task would become. Alternative B of the draft directives more nearly fitted his prescription of what was needed over the next several months than did alternative A.

Mr. Patterson remarked that the Sixth District's economy seemed to be continuing to tug at the remaining restraints on vigorous expansion, although not all of the indicators were strengthening. The District's bankers continued to talk about an impending upsurge in loan demands, and there were some who stated that "tight money" was forcing them to firm terms and conditions of loans. So far, growth in total loans at the large banks had

been very slow, with business lending remaining subdued. In addition, the low level of member bank borrowing and continued additions to investment accounts at the large banks suggested that this sentiment of restraint was based more on anticipations than realizations. Some fears were being expressed about an adverse deposit situation that might develop because of the inability to compete effectively for time deposits, but that was in the future. At banks outside the major cities, loans continued to grow.

Mr. Patterson observed that for the past several months a good many members of the Committee had believed that the System was underwriting too great a rate of growth in the money supply and bank credit. However, doubt about the strength of the recovery, lack of knowledge of Congressional action on taxes, almost continuous Treasury financing, and the possibility of creating further balance of payments difficulties for the British seemed sufficient reasons at various times to forestall tightening. Now, the readings on the economic outlook for the nation were apparently strong enough to suggest the economy could stand a less liberal expansion of the credit base; the Treasury's credit demands had lessened; and--instead of the possibility of tightening conditions adversely affecting the British--interest rate differentials had turned against the United States. The Committee was, of course, still in doubt about Congressional action on the tax front.

Thus, Mr. Patterson continued, there was a great temptation to conclude that this was the time to take the overt step toward more credit restraint the Committee had wanted to take for some time. Indeed, the temptation was great to conclude that a decisive shift in policy was required now more than ever because of international developments.

Mr. Patterson was not sure, however, that things had settled down enough for the Committee to be about to sort out the various factors affecting the money and capital markets. The rise in rates since devaluation without any major change in reserve availability was probably exerting some restraint by itself. Although it was quite possible that the Committee might have to shift toward more restraint in the future, at present it seemed preferable to maintain about the present conditions in the money market rather than risk the chance of creating unsettling conditions. Postponing another increase in the discount rate and retaining the present Regulation Q ceiling on CD's would be part of the package. He would, therefore, prefer alternative A of the draft directives.

A footnote of some possible interest, Mr. Patterson said, was that about ten days ago the Atlanta Bank's Research Department conducted a seminar on monetary policy at one of the Bank's branches with about 45 professors of money and banking. After reviewing current domestic economic and credit conditions and

discussing policy implications, 60 per cent of the professors expressed a preference for having the System supply reserves less liberally, and an equal number preferred to keep the discount rate unchanged. Members of the group voted two to one against raising the Regulation Q ceiling on CD's.

Mr. Bopp said that in spite of the relatively weak performance of the consumer sector, it was clear that the economic advance was continuing. Most indicators in the Third District also were improving. Final demand had strengthened; the unemployment rate fell to a new 1967 low in October; and manufacturing output was 2 per cent above the 1966 high. But, less cheering, in the District as nationally, price increases continued to spread.

In light of the probable continuation of such developments, and assuming no tax change earlier than the second quarter of 1968, Mr. Bopp's judgment was that net gains still were to be had by a move away from the present degree of ease. He reached that conclusion even though some of the reasons for no change were more persuasive now than they had been as late as a month ago, and even though the costs of such a move had increased relative to possible gains.

Mr. Bopp remarked that among the considerations against a move toward less ease was the fact that another round of price increases had already been built in and monetary policy could do

little to prevent them. Moreover, the probabilities were good that the immediate impact of less ease would be to create further uncertainties in the already skittish money and capital markets. And there was a chance that much of the impact of any tightening now would be felt just when the economic upturn was losing steam.

Nevertheless, Mr. Bopp continued, in spite of monetary policy lags, it was still not too late to affect some spending decisions in early 1968, particularly those relating to consumer purchases and inventory accumulation in anticipation of higher prices. Even though further price increases were inevitable, tightening now might limit their spread. And to the extent that more inflation could be avoided, the economic distortions it caused and the subsequent adjustments those distortions required would be lessened. Finally, although the outlook for the economy after mid-year was now for less strength, that was still conjectural. Whether it in fact materialized would depend partly on what happened in early 1968.

One of the most serious risks of a policy of less ease was of course, disintermediation, Mr. Bopp said. However, thrift institutions seemed to be in a better position now to meet an outflow of funds than in 1966. That was borne out for the Third District by the Reserve Bank's survey last week of 15 large thrift institutions. As a result of a slowdown in the rate of mortgage

commitments and reduction of Federal Home Loan Bank debt, most of those institutions now felt their liquidity position was substantially improved over "pre-crunch" 1966. Of course, that was no guarantee that outflows could not occur so fast and in such volume as to cause serious problems. But, even if significant disintermediation were to occur, there were ways of handling the problem outside of the area of monetary policy.

Mr. Bopp continued to believe that a move away from monetary ease would be appropriate, even though it might be getting late in the day. In his judgment the potential gains still outweighed the risks. He recommended a modest move toward less ease, but would give the Desk sufficient freedom to mitigate undesirable market reactions. He favored alternative B of the draft directives.

Mr. Hickman remarked that, as expected, the economy was rebounding from the strike-depressed levels of early fall, with strength apparent in many areas. The economic situation in the Fourth District had improved even more rapidly than in the nation, with manufacturing activity, employment, and income showing considerable strength in October and November. Further sizable gains were expected in December, in the District and in the nation.

Mr. Hickman said his staff and he were in general accord with the views on the economic outlook expressed in the green

book.1/ Barring further work stoppages, the acceleration of auto production, coupled with a buildup of steel stocks as a strike hedge, would provide a sharp stimulus to aggregate demand in the first half of 1968. There would also be rapid growth in personal income because of rising output, higher wages, and enlarged social security benefits. As a result, serious demand-pull influence, would be superimposed on cost-push forces, thus increasing inflationary pressures.

In view of that outlook, it seemed appropriate to Mr. Hickman to make a modest move toward less ease at this time. As he had said several times before, the Committee should aim for average growth of bank credit at an annual rate on the order of 6 to 8 per cent over an extended period of time, which meant that it should look beyond the low figure projected for December to the strong loan demands anticipated for early 1968. To counteract large loan commitments now, which might lead to excessive loan volume later on, he recommended that the Committee strive for moderately firmer money market conditions, allowing the average rate on Federal funds to move above the discount rate, and the 91-day bill rate to drift above 5 per cent. While the international situation made it difficult for the Manager to maintain a firm rein on conditions in domestic financial markets, Mr. Hickman

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

did have the feeling that the money market was now somewhat easier than desirable, given recent and prospective wage-price pressures.

Mr. Hickman thought an additional consideration for moving now was that the Committee's hands might be tied at the next several meetings by Treasury financings, as well as by the spate of official reports and messages that were due after the first of the year. Another reason for moving today was that Congress had not taken appropriate action on fiscal policy and might not do so for some time, if at all. No change in monetary policy had been appropriate while there was a chance that Congress might act in this session, but the burden now was clearly on the System to take whatever reasonable steps were necessary for prudent public policy.

Finally, Mr. Hickman saw little risk in a slightly firmer monetary policy at this time. With the widespread expectation of ebullient economic activity in the first half of 1968, whatever steps the Committee took now to moderate bank credit growth should work to the long-run stability of the economy. If, as some forecasts suggested, the economy reverted to more moderate rates of growth in the second half of 1968, the Committee would have sufficient time to reverse its field and promote more active credit growth. It followed from these views that he would favor alternative B for the directive. Moreover, to relieve pressure on the Euro-dollar market, he thought the time was near for some action on Regulation Q ceilings for large CD's.

Mr. Sherrill said he found the choice between alternatives A and B for the directive to be very close but on balance he favored alternative A. He thought both alternatives tended in the direction of restraint, which he considered to be the appropriate direction for policy at this time. Alternative A, in effect, called for confirmation of the firmer conditions that had developed in the money market in reaction to the discount rate increase, whereas alternative B called for the System to take the initiative in achieving somewhat firmer conditions.

He was attracted to alternative A, Mr. Sherrill continued, primarily because the blue book suggested that the 3-month Treasury bill rate was likely to remain in a 4.80 - 5.10 per cent range over the next four weeks under that alternative, whereas the bill rate might go as high as 5-3/8 per cent under B. He thought there was a great risk of disintermediation at thrift institutions in coming weeks, associated with the dividend crediting period around the turn of the year. Mutual savings banks in New York recently had been experiencing the lowest rate of deposit inflow in some time. Moreover, their passbook loans were at a level almost double that of a year ago, suggesting that a sizable volume of deposits would be withdrawn after dividends were credited. Those conditions were not confined to New York; they seemed to be prevalent at thrift institutions across the country. To have bill rates rise as high

as 5-3/8 per cent in coming weeks would increase the risks of serious disintermediation.

Mr. Sherrill said he had also been quite impressed by Mr. Partee's analysis suggesting that the present level of interest rates was exerting considerable restraint rather than simply reflecting the existence of inflationary premiums. It was also significant that there recently had been a definite slackening of growth in the monetary aggregates.

In a concluding comment Mr. Sherrill observed that he would favor considering an increase in reserve requirements after the turn of the year. Such an action might offer a means for reducing credit availability while maintaining interest rates at levels that would not put pressure on Regulation Q ceilings and that would not result in disintermediation so serious as to depress activity in the housing sector during 1968, particularly the second half.

Mr. Brimmer said that he would suggest certain modifications of the language of the draft directives to emphasize the fact that by increasing the discount rate the System had already moved in the direction of firmness. Although the discount rate action had been taken primarily with international considerations in mind, it of course also had implications for the domestic economy, and it was desirable for the Committee to keep in view

the effects of all monetary policy actions rather than focusing exclusively on open market operations.

At the same time, Mr. Brimmer continued, the Committee should exercise caution to avoid putting unnecessary pressures on savings and loan associations and mutual savings banks around the turn of the year, particularly since institutions with semi-annual, as well as those with quarterly, dividend crediting periods would be under strain at that time. Mr. Partee had said in response to a question that he was unable to predict the seriousness of the difficulties which thrift institutions would encounter, but most observers expected that the runoff in their deposits would be sizable.

On the other hand, Mr. Brimmer said, he did not think the possibility of disintermediation should be the determining factor in the policy decision today. The Committee might have to run the risk of some disintermediation; its objective should be to minimize the risk rather than to avoid it.

The Committee also should exercise caution to avoid reducing the System's options with respect to Regulation Q, Mr. Brimmer continued. While it might prove necessary to raise the ceiling rates, at least on large-denomination CD's, it would be undesirable for the System to find itself in a position in which that action was unavoidable.

Turning to the directive, Mr. Brimmer noted that the first paragraph of both alternatives was the same except for the concluding sentence describing the Committee's general policy stance. He would favor using the version of that sentence given in alternative B, which read: "In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resistance of inflationary pressures and progress toward reasonable equilibrium in the country's balance of payments."

As to the second paragraph, Mr. Brimmer favored language calling for money market conditions in between those specified in the blue book for alternatives A and B. Like Mr. Sherrill, he believed that seeking the conditions specified for alternative B would be going too far in view of the risks of disintermediation in coming weeks and the potential pressures for an increase in Regulation Q ceilings. He thought there should be a reference to the recent discount rate action, such as was incorporated in alternative A but not B. In effect, the Manager should be instructed to initiate action to reinforce--but only slightly and not too rapidly--the firmer money market conditions that had developed after the discount rate increase. For the proviso clause, he preferred the version given in A. Altogether, he would propose a second paragraph reading as follows: "To implement this policy, System open market operations until the next meeting of

the Committee shall be conducted with a view to moving slightly beyond the firmer conditions that have been achieved in money markets partly because of the increase in Federal Reserve discount rates; provided, however, that operations shall be modified as needed to moderate any apparently significant deviations of bank credit from current expectations."

Mr. Brimmer said he agreed with the view others had expressed that the System should begin to give thought to a possible increase in reserve requirements early in 1968, to supplement the type of firming action he proposed the Committee should take today. At his suggestion the staff had put together some estimates of the effects of an increase of one-half of a percentage point in reserve requirements against, first, net demand deposits, and secondly, net demand deposits over $5 million at each bank. The latter alternative had been considered in light of recent suggestions by Mr. Galusha and others that some effort be made to restructure reserve requirements, and in light of the possibility that such restructuring might be feasible in a period in which policy was being tightened even if it were not feasible in a period of easing. Although the estimates offered only rough orders of magnitude, they suggested that if either type of increase was put into effect at appropriate times for reserve city and country banks in January, they would serve to absorb most of the

$800 million of reserves which present projections indicated would have to be absorbed in that month.

Mr. Maisel said it was clear that all members of the Committee were concerned over the economic prospects for the next year as well as the role to be played by the Federal Reserve in that period. He thought it vital that the Committee express its concern by careful selection of the goals it hoped to achieve when it formulated monetary policy.

It was probably simplest to pick an ultimate goal, Mr. Maisel remarked. While some might disagree, he would pick, as an objective of policy, growth in the total GNP for 1968 over 1967 of 7 to 8 per cent. Monetary policy should aim at cooperating in achieving that goal.

A more difficult problem, Mr. Maisel continued, was picking the specific target for monetary policy which would give the greatest aid to achieving that over-all goal. Two major possibilities existed for setting the target. The target could be expressed either in terms of expansion rates for money and credit or in terms of desired interest rates. The major variable in achieving either of those targets would be the amount of reserves furnished as a result of System action and member bank borrowing.

Mr. Maisel believed that a proper target for the coming year would be to hold the expansion of total deposits of all

deposit institutions in the same range as that hoped for the GNP, i.e., between 7 and 8 per cent. Some might argue that that was too deflationary a target because it reversed rather drastically the history of the past year and of the past seven years. In the past year, total deposits expanded at a rate 80 to 90 per cent faster than the growth rate for the GNP. For the entire seven years, deposits expanded at a rate one-third faster than the GNP; and in most of the years, except for 1966, that ratio was exceeded.

Mr. Maisel noted that others might prefer an interest rate target, whether it be in terms of long-term rates or of money market rates as expressed in alternative B of the draft directives. He would hesitate to adopt an interest rate goal because he saw no clear indication of what it should be. Long-term interest rates were now at their highest level in history. Their rate of advance thus far this year had been virtually unprecedented. How those rates would affect the long-run welfare of the country through their impact on capital formation, including housing, was unclear. The Committee should certainly expect, however, that if those rates went higher their impact both on financial markets and on real investment would rise exponentially. As had been brought out, markets were unsettled and skittish.

It was for those reasons that Mr. Maisel opposed alternative B for the directive. What specifically would the Committee be aiming

at if it set firmer money market rates as a target to be achieved by the Manager? They, by themselves, were not a target or a goal. Money market rates would in fact depend primarily on expectations of further moves. Setting them as a goal would amount to a reaction to conditions rather than a choice of the situation the Committee hoped to achieve.

As opposed to that course, setting a target in terms of growth in money and credit seemed proper to Mr. Maisel. Monetary policy at this time should be concerned with the quantity of the monetary and credit variables. Their expansion should be limited to what appeared logical based on past history and the increase desired in GNP. Currently, the Committee need not give demand an additional push from the credit side.

Mr. Maisel said he favored a quantitative goal even though he recognized that a shift in the demand for liquid assets had led to record interest rates; that in the past five months business loans had had their smallest expansion since the second quarter of 1961 (excluding the last quarter of 1966); and that, excluding securities, the rate of expansion for all loans was relatively low. He welcomed that degree of restriction in demand which monetary policy was achieving because of the high level of interest rates and because financial institutions desiring to maintain liquidity were not pushing out funds.

As was made clear by the language of alternative A, Mr. Maisel continued, monetary policy had firmed. While the matter was not certain, it appeared likely that recent policy was sufficiently restrictive to achieve the Committee's ultimate goals. In fact, policy might be too restrictive for the purpose. A problem might arise if, in addition to current high rates, availability was still further restricted as disintermediation proceeded. For the time being he was willing to face that danger by allowing rates to rise if, but only if, the market demanded more funds than the System should supply to finance a normal expansion. The System was not furnishing easy credit and alternative A did not call for such a program. It called for firm rates with a possibility of extremely high rates. Any added restriction would lead to a negative expansion of bank credit in the next period.

Mr. Maisel said that, as was indicated by the directive he had proposed at the time of the November 14 meeting, he thought that one of the best ways of achieving a target of limiting deposit expansion might be through a directive based on maintaining currently firmer conditions with an added proviso based on total reserves. Even in the light of the extremely chaotic changes of the past month, if such a directive had been adopted a month ago it would have worked out well. However, the staff had advised him that they did not find much evidence that other members of the

Committee desired to make that kind of shift in the basis of the proviso. So, as a second choice, he would support the type of proviso found in alternative A. Clearly, the two types of proviso could be related. The main weakness of the current proposed directive was that it did not give as clear an indication of the type of action the Manager should take if the proviso came into effect as would a directive with a proviso based on total reserves.

Mr. Maisel added that he welcomed Mr. Brimmer's suggestion for including a reference to the discount rate action in the second paragraph of the directive. He did not favor the other changes Mr. Brimmer had suggested, and in those connections he would prefer to retain the language of alternative A as orginally drafted.

Mr. Mitchell said that despite the discussion in the green book he thought the business outlook still remained a little foggy. The expectations of rapid expansion in early 1968 had been generated by various Government actions, including the Federal employee pay increase, enlargement of social security benefits, and the rise in the minimum wage rate. In the absence of those actions the outlook for the first half of the year would not have been particularly strong. He considered Mr. Brill's position that a full-employment economy had already been attained to be unrealistic in view of the rate at which plant capacity was being utilized at present. Admittedly, if he were asked for a single, unqualified prognosis

for the economy his response would be much like that given in the green book. His point was that he would be a good deal less certain of the reliablilty of that prognosis than the staff evidently was.

Mr. Mitchell went on to say that the staff seemed to be recommending that the Committee take steps that would cause a recession, and perhaps a recession was what was needed to stop inflation. One alternative would be to continue to wait for Congressional action on a tax increase, but like others who had spoken today he would not favor doing so. Mr. Partee's analysis today, which had impressed him considerably, suggested an appropriate course of action. His (Mr. Mitchell's) version of that course would involve, first, attempting to influence expectations, not through official statements but by tranquilizing growth in the money supply. Whatever the monetary theory to which one subscribed--and he knew that a number of members of the staff did not give central place to the money supply in their theorizing--it was a fact of life that to many outside observers "monetary ease" meant rapid growth in the money supply, narrowly or broadly defined. Such observers, both at home and abroad, would not be convinced that the System intended to reduce the degree of monetary ease until it had slowed money growth.

Something more than that might be required to influence attitudes abroad, Mr. Mitchell remarked. He thought his preference

probably would be to raise reserve requirements early in 1968, but he would also be willing to consider another increase in the discount rate at that time. Meanwhile, he would favor urging the Treasury to continue to sell gold freely to unwilling holders of dollars.

Apart from influencing expectations, Mr. Mitchell continued, some actions were in order to affect economic activity directly. For this purpose also, he would suggest that growth in the money supply should be tranquilized. He thought the Committee should use an aggregative guide for policy on the "black box" theory; one need not know just how a change in money supply growth would affect activity to conclude that a slowing in that rate of growth now would have desirable effects.

Mr. Mitchell said he was prepared to go along with a policy course under which System operations raised short-term interest rates to the point at which intermediation was halted. He would not want the System to get into a position in which it was forced to raise Regulation Q ceilings; that, he thought, would defeat the purpose of the operation. Such firming action would have distributional effects; some would-be borrowers would not get the credit they sought. But monetary policy inevitably involved inequities. He would not be disturbed if, as a result of System action, the Treasury had to pay very high interest rates in

its January financing, since such a development might help bring home to Congress the need for a tax increase.

Mr. Mitchell said that the main effects of policy action now probably would not be felt until next summer or fall; except for the impact on expectations, not much could be achieved with respect to the next few months. He thought that anything the Desk did to firm market conditions should be done in moderation. In particular, firming should not be carried to the point at which it triggered disintermediation. Timing was extremely important; no firming operations should be undertaken for the next week or so, and not much should be done until the dividend crediting period at thrift institutions had passed. And the Committee should be prepared to reverse its field if Congress enacted a tax increase.

In conclusion, Mr. Mitchell observed that it probably would prove possible to reduce the rate of growth in the money supply broadly defined, but that was less certain with respect to money on the narrow definition. For the directive, he preferred the language Mr. Brimmer had proposed to either of the staff's alternatives. But the policy course he favored could be accomplished under any of the three versions, sympathetically construed, and he could accept any of the three if the Manager thought he could live with them.

Mr. Wayne reported that business activity in the Fifth District appeared to be advancing about in line with the national

economy. The latest information suggested that retail sales in the District, in both durables and nondurables, were considerably stronger than in the nation at large.

In the broader context of the current national and international picture, it seemed to Mr. Wayne that the developments of the last three weeks had altered significantly the dimensions of the policy problem the Committee had been confronting since last summer. Over much of the past six months, he had felt that the developing domestic situation clearly called for restraint. Because of excessively nervous credit markets and the precarious position of the pound, however, he had been equally convinced that restraint through credit policy action involved unacceptable risks on both the domestic and international fronts. Accordingly, he had been prepared to accept what he considered to be an overly rapid credit expansion in the hope that the obviously necessary restraint would be forthcoming through fiscal action.

As Mr. Wayne interpreted the events that had unfolded since mid-November, they had made restraint all the more imperative and at the same time they might have relaxed the constraints on the Committee's action. He had hoped that by this time the combination of the British devaluation and the 8 per cent Bank rate would have led to a large return flow of dollars to London and to a good prospect for an early return to a lower Bank rate. Unfortunately that had not been the case.

With regard to the domestic situation, Mr. Wayne continued, the latest data showed more clearly than ever that the economy was in an inflationary surge. Financial markets appeared increasingly convinced of that and there was evidence that they had already discounted a moderate tightening move on the Committee's part.

Finally, Mr. Wayne said, public attention was now focused more closely on the dollar and on the United States' own balance of payments problem. He was convinced that over the next few months published balance of payments figures would assume an enlarged significance in market expectation patterns both here and abroad. For that reason, he felt that the external accounts must be given greater emphasis in the Committee's deliberations. Clearly, those accounts called for greater restraint.

If, over the next three weeks, the pound's near-term prospects should brighten and domestic markets began to firm, Mr. Wayne would favor making a definite and unmistakable move to reduce reserve availability. But even if those conditions did not materialize, he believed there was enough headroom for the Committee to begin a probe in the direction of less ease and accordingly he favored such a move. He was aware that that kind of probe involved some risk of a rate reaction and of some disintermediation, but he did not consider that risk to be unacceptably great. For the present, he would leave the discount rate unchanged pending developments in the market for sterling.

Mr. Wayne said that while he could accept Mr. Brimmer's suggested revision of the directive he preferred alternative B of the staff's drafts. He noted that the anticipated effects of adoption of that alternative were indicated on pages 7 and 8 of the blue book.1/

1/ The blue book passage to which Mr. Wayne referred read as follows: "A firming of money market conditions might include Federal funds averaging 4-5/8 per cent, and sometimes trading above that rate, member bank borrowings generally in a $150 - $250 million range, and the net free reserve position of banks in a zero to $150 million range. The attainment of such conditions is likely to be associated with a further upward movement in bill rates, as dealer financing becomes more expensive and especially if expectation of a further rise in the discount rate become prevalent. The 3-month bill might move into a 5 - 5-3/8 per cent range, with market attitudes about the direction of monetary and fiscal policies and regulatory actions on rate ceilings a key factor in determining emerging rate levels. Long-term rates are also likely to rise somewhat further, particularly if convictions grow that banks will be unable to remain active in municipal and mortgage markets and that nonbank intermediaries will become less able to compete effectively for savings flows.

"With a firming of money market conditions such as described above, commercial banks would find it more difficult to replace maturing CD's with even shortest-term issues. Over-all, the attrition of CD's in December may become larger and would be likely to continue into January. There would also be further reductions in net inflows of other time and savings deposits at banks--and also at nonbank financial intermediaries. The reduced availability of domestic time deposit funds to banks, given existing Regulation Q ceilings, would tend to increase the aggressiveness with which U.S. banks compete for Euro-dollar funds, thus amplifying rate pressures in that market.

"If a move toward greater firmness in money markets is achieved gradually, the December bank credit expansion might be only a little lower than projections of expansion under present money market conditions. In January, however, one would not expect much, if any, rebound from the relatively low December bank credit expansion. The expansionary effect on bank credit from bank participation in the January Treasury financing would probably be offset by pressures on banks to withdraw from securities markets as their ability to expand liabilities is further curtailed."

Mr. Clay commented that the American economy faced problems both domestically and internationally requiring a considerable measure of restraint. On the domestic side, costs and prices continued to advance and the prospects were for further increase. It appeared probable that economic activity would expand sharply in the months ahead, with stronger demand for goods and services developing. Qualified labor already was scarce before the anticipated upsurge of activity occurred. Little could be done in any feasible way about the cost-price pressures that already had been built into the economy, but it was important to restrain future price increases and to maintain balanced economic growth.

Serious as was the cost-price problem in terms of domestic considerations, Mr. Clay said, cost-price restraint might be even more important in terms of international considerations. There was no need for him to review the worsening of the international balance of payments deficit and the deteriorating international balance of trade, or to note that the U.S. competitive position appeared to be deteriorating as well. But that was the situation which confronted this country. The fact that the U.S. Government was seriously burdened with foreign financial costs, military and otherwise, only underscored the importance of dealing with fundamental aspects of the problem.

In Mr. Clay's view, there were a number of steps that needed to be taken through both private and public policy actions in this

country, including actions by business, labor, and government, to bring a better balance of economic forces. That was not within the Federal Reserve's authority to bring about. Moreover, it probably could be agreed that the most important place to begin was with fiscal policy, by taking restraining actions through both expenditures and taxes. Such action also would be helpful in the formulation of properly coordinated fiscal-monetary policy. That too was not within the Federal Reserve's authority to bring about. The Federal Reserve was left in the position of having to evaluate the role of monetary policy under the circumstances that did exist.

Mr. Clay thought that, in view of the current and prospective domestic economic situation, and the international balance of payments problem, a moderate measure of restraint should be applied through a gradual firming of monetary policy. Fiscal legislation prospects and Treasury financing did not seem to be obstacles now. There was a possible problem of disintermediation, particularly with reference to negotiable CD's, and it might become necessary to modify open market operations if liquidity pressures became severe. It also could be pointed out that projected bank credit growth was smaller than it had been in past months. Those estimates were quite uncertain, however, and there was no assurance that that slowdown in bank credit growth was not quite temporary. Treasury financing, and possibly loan demand, would be expanding bank credit as the economy moved into the new year.

The policy course he favored might be carried out in terms of the targets specified on page 7 of the blue book, Mr. Clay said. Alternative B of the draft directives was satisfactory to him.

Mr. Scanlon commented that businessmen, lenders, and the general public appeared to be more agitated concerning economic developments than in any recent period. Rising prices, strikes, the war, high interest rates, the devaluation of the pound, the gold rush, the tax debate, and social unrest all had worked to create an atmosphere of apprehensive uncertainty that might impede some spending and investing. Nevertheless, the anticipated renewed uptrend in activity was beginning to emerge, propelled mainly by the continued growth in income, credit, and money, but also reflecting special situations in the automotive and steel industries.

Mr. Scanlon noted that more than 780,000 passenger cars were scheduled for assembly in December, an annual rate of about 9.5 million, compared to a total of about 7.4 million for all of 1967. First-quarter production might approach 2.5 million units, almost as many as in the very strong first quarters of 1965 and 1966. Inventories of autos amounted to only a 37-day supply on November 30, compared to 40 days a year earlier. Unquestionably, sales would be stimulated by larger inventories, not only of Ford cars, but of other makes as well. Dealers with autos to sell had

been taking advantage of the sellers' market to maintain high profit margins.

In view of the lateness of the hour, Mr. Scanlon said, he would submit the remainder of the comments he had prepared on District conditions for the record. Those comments were as follows:

> Steel production seems certain to rise sharply in the months ahead. Hedge buying, which started in November, is expected to pick up speed. Some customers seek to schedule deliveries so as to avoid property taxes and this is deferring some deliveries. Steel shipments are expected to reach 24 million tons in the first quarter, the highest level since the second quarter of 1966. A number of steel firms have indicated that orders recently have been equal to production capacity. Steel firms in the Chicago-Gary area are actively seeking workers, and now indicate that availability of labor may restrict their production.
>
> Although higher than last year, unemployment rates in all District States remain well below the national average. Labor markets are almost certain to tighten (allowing for seasonal trends) in the months immediately ahead. Help wanted advertising rose in October and November after declining in the first three quarters of the year.
>
> Sales of appliances, TV sets, furniture, and other durables are likely to rise, however, along with the expected increase in auto sales. There is some evidence that inventories of these items are inadequate.
>
> Information available to us from District firms indicates that orders for producers' durable equipment have improved, but only moderately, in recent months. Machine tool orders remain low relative to a year ago. Orders for components--drives, gears, bearings, controls, etc.--which usually lead production of machinery and equipment by several months, have risen following the sharp decline in the first half of 1967, but the rise is not vigorous.
>
> Construction contracts in the District have been very strong. In October contracts exceeded their year-ago level by one-third. Some very large awards for manufacturing projects were included in the October

data. In the June-September period gains ranged between 12 and 30 per cent. Residential contracts in the first 10 months of the year were up 12 per cent from 1966 in the District, compared to 3 per cent for the nation.

Farm income estimates probably will be revised downward, especially in the Midwest, mainly because prices for feed grains and meat animals have been lower than expected. The corn harvest is lagging and some corn has been sold at discount prices, because of high moisture content.

Loan demand has continued moderate at Seventh District banks. Although the November expansion in business loans contrasts with last year's decline, the increase thus far for the fourth quarter is considerably less than in other recent years. November demand was mainly from public utilities. The survey of lending practices, however, shows that respondents in the District are nearly unanimous in their expectations of stronger loan demand in the period ahead. Most banks also reported a firming in lending terms prior to the prime rate boost. Several banks, with an eye to their commitments, seem reluctant to take on new customers.

Meanwhile, large Chicago banks have continued to maintain relatively liquid positions that should enable them to increase outstanding loans substantially, barring a major run-off of CD's. They have been acquiring CD money rather actively in the short-maturity areas, and have reported a sizable increase in borrowings other than Federal funds. Holdings of agency issues and municipals, some short-term, have risen. These banks also have been buying bills and selling Federal funds.

Regarding policy, Mr. Scanlon said that in view of recent and prospective economic developments he continued to favor slower rates of monetary and credit expansion. He believed it would be unfortunate if the market became convinced that not only would the desired fiscal restraint be lacking but that easy money would continue indefinitely as well. The projections for December were for slower growth in most monetary and credit aggregates. He would

like to see the Committee try to maintain some of that firmness into the first quarter of 1968. Mr. Brill's comments about the economic outlook for the months ahead seemed to call for a less easy monetary policy. In view of the Treasury calendar, the present time appeared to offer one of the few opportunities the Committee would have to make a move in the weeks ahead.

To the extent the Committee could move without seriously disrupting the market, Mr. Scanlon said, he would favor doing so. He preferred alternative B for the directive, but the language Mr. Brimmer had suggested might be acceptable to him.

Mr. Galusha commented that, in this "winter of our discontent," there was little to distinguish the Ninth District from the rest of the nation, so he would be brief in his report about it. The Ninth District, too, had labor unrest. The copper strike was still going on and, according to his pessimistic Montana friends, it might not be settled until next March. And there was considerable agricultural unrest. Farmers were unhappy about prices, and cattlemen about beef imports.

Mr. Galusha said he would relate an encouraging story, which was also a true one. A few days ago a well-dressed man walked into the Minneapolis Reserve Bank with forty-odd twenty dollar gold pieces, which he wanted to redeem for twenty dollars each in cash. Having redeemed them, he departed, but only to

return with another one hundred and forty gold pieces, again to be redeemed at face value. His only explanation was that the country needed the gold pieces more than he or a coin collector did. The one hundred and eighty-odd gold pieces were forwarded to the Denver mint, after assurances were given to the mint that the man who had turned them in was rational. He (Mr. Galusha) might add parenthetically that after listening to the reports and discussion this morning, he thought the man's actions might prove to be one of the few rational responses to recent monetary developments anywhere in the free world.

With that preamble, Mr. Galusha said, he would turn to open market policy. The Committee should, he believed, follow the example of the man with the gold pieces, and do what might seem to be against its own short-run interests--which was to say, effect a modest increase in monetary restraint and start talking with the Federal Home Loan Bank Board and the Federal Deposit Insurance Corporation about increasing rate ceilings if substantial disintermediation occurred.

Mr. Galusha observed that the reasons for increasing monetary restraint now had been adequately covered in the discussion today, and he would not dwell on them. He favored an increase in Regulation Q ceilings because of his concern about the housing industry and the British situation. It seemed

to him that increased monetary restraint, if not accompanied by an increase in those ceilings, would hurt the British badly and, closer to home, the U.S. housing industry as well. It certainly was clear from the discussion that the British were far from being out of the woods, and increasing the ceiling rate for large-denomination CD's was a way of minimizing the adverse consequences for them of increased monetary restraint in the United States. But then simply increasing the ceiling rate for large-denomination CD's was not going to prevent disintermediation or help the housing industry. For that, ceiling rates on consumer CD's must also be increased, along of course with the ceiling rates for savings and loan associations and savings banks. Even if those ceiling rates were raised housing output would likely decline since, as he believed, prospective house purchasers were emotionally attached to mortgage rates in the six per cent area. But what the Committee should be interested in doing was minimizing the selectively harmful consequences of cutting a speculative inventory buildup by means of increased monetary restraint; and that called for not pinching off the supply of mortgage funds.

Given the objective of moderating a bank-financed inventory buildup, Mr. Galusha continued, it was tempting to think that that could best be done by maintaining present Regulation Q ceilings. Possibly that was right. He would again emphasize, however, that,

say, reducing the target level of free reserves without increasing Regulation Q ceilings was going to do maximum harm to the housing industry and to the British, and risk another near-disastrous credit crunch.

All things considered, Mr. Galusha said, he was for alternative B of the staff directives--and for increasing Regulation Q ceiling rates to appropriate levels. He had a great deal of sympathy for Mr. Brimmer's suggestion that this might be the time to start thinking about restructuring reserve requirements.

Mr. Swan said that there had been no major changes in economic conditions in the Twelfth District recently, so he would turn directly to the question of policy. Like Mr. Mitchell, he was not completely persuaded by the staff's projections of economic activity in early 1968 but was prepared to accept them as best estimates. It seemed to him that the rate of monetary expansion so far this year--whether measured in terms of the money supply narrowly or broadly defined or in terms of bank credit--was a matter of considerable concern, and certainly was too high a rate to be sustained if business activity would be expanding in the first half of 1968 at a pace anywhere near that the staff expected. The U.S. balance of payments situation and international financial developments generally strengthened the case for a firmer monetary policy. Moreover, the Committee's policy choices no longer were constrained by the hope of a tax increase this year.

On the other hand, Mr. Swan continued, bank credit was increasing at a very moderate rate in December, and some firming of money market conditions had already been accomplished in connection with the discount rate increase. Moreover, there were various uncertainties with respect to the period from now to the end of the year, including the risk of disintermediation. In view of that risk he had planned to raise the question in the discussion today of the implications that adoption of alternative B for the directive would have for open market operations in the weeks immediately ahead. However, the problem that had concerned him would be resolved if the Committee adopted the directive language Mr. Brimmer had proposed. He would prefer that language to either of the staff's alternative drafts.

Mr. Swan remarked that he was not yet prepared to say that he would advocate an increase in reserve requirements in January. He thought, however, that serious consideration should be given now to such an action as a more overt step toward a firmer monetary policy, at least if the period immediately ahead posed no undue problems in financial markets. If reserve requirements were increased, the Committee would, of course, remain free to decide whether open market operations should be used to reinforce that action or to offset part of its effects. He would not advocate another increase in the discount rate at the moment, but that possibility might be considered after the early part of the year.

Mr. Irons said that there had been relatively few significant economic developments recently in the Eleventh District. One notable fact was the great strength evident in consumer demands for all types of goods; department store sales were up markedly from both the previous month and a year ago. With regard to financial conditions, District banks were in a reasonably liquid position. There had been no borrowing from the Dallas Reserve Bank on a number of days during the past few weeks. It appeared that banks were meeting any reserve deficits through the Federal funds market.

Turning to policy, Mr. Irons remarked that for the past several months the Committee's discussions had been carried on against the bankground of various kinds of uncertainties and shifts in expectations. He thought the point had now been reached, following the adjustment of interest rates to the discount rate action, at which conditions justified some further moderate firming in the money market. In his opinion, inflation was no longer a threat; the economy was now in an inflationary cycle. That fact appeared to be widely appreciated by businessmen and was affecting their policies. It was now clear that a tax increase would not be enacted this year, and he doubted that it would be enacted early next year. The international financial situation had deteriorated and the problems in that area might

well intensify. Certainly the U.S. balance of payments was in a serious condition.

It was true, Mr. Irons continued, that interest rates were already at a high level, and that many market observers expected them to rise further. To some extent the market was probably discounting further firming actions on the part of the System. There was a risk that a firmer policy might result in problems in connection with CD run-offs and might lead to pressures to raise Regulation Q ceilings. The System would have to deal with such problems if and when they arose. The Manager should be given a considerable degree of leeway so that he might be able to alleviate any such problems.

Mr. Irons said that he had concluded earlier that alternative B of the draft directives would fit his prescription for policy for the next four weeks. After hearing Mr. Brimmer's suggested language, however, he thought that language also might be acceptable.

Mr. Ellis commented that economic conditions in New England reflected the national pattern without serious distortion, and the outlook for the next several months seemed to be one of expanding activity. Department store sales were showing impressive gains, construction activity was improving, employment was rising, and the banks reported both present and expected expansion in loan demand.

Mr. Ellis said his analysis of the national outlook tended to vary from the staff presentations only in degree and timing, not in direction. For example, the green book saw "evidence of a leveling off of military expenditures" in the "relationship between purchases and contracts." He would, of course, agree that the data showed that "spending appears to have caught up with the prevailing level of contract awards," as the text related, but the data also showed contract awards still to be rising. He would personally expect that Secretary McNamara's departure from the Pentagon was more likely to result in renewed rise in defense outlays than the reverse.

Again, Mr. Ellis continued, starting from a position of basic agreement with the staff projections of the credit aspects of the near-term future, he would challenge any sense of satisfaction or complacency that might be associated with the projections that total reserves and the bank credit proxy would increase only moderately in December. As noted by Mr. Partee, the staff expected bank credit growth to be larger in January than in December. Moreover, in five of the past seven months the initial projections of total reserves and bank credit had fallen short of the final results by an average of about 2 or 3 percentage points. In every one of the past seven months the initial projection of the money supply had fallen short of the

final figure. Judging by that experience, the recent average understatement of 3.7 percentage points should be added to the 5.5 per cent annual rate of increase in the money supply projected for December, to arrive at a corrected estimate of 9.2 per cent.

Mr. Ellis said this excursion into the labyrinth of numbers was intended only to emphasize that the basic situation continued to be one in which the System was continuing to increase reserves, bank credit, and the money supply at rates that would surely intensify inflationary pressures in view of the projected economic trends. For example, the green book indicated that total reserves had increased at a 10.6 annual rate and bank credit at a 12.3 per cent annual rate on average in recent three-month periods. A lessened rate of money creation was clearly indicated for domestic economic reasons. He felt no sense of embarrassment in talking about the monetary aggregates; the System was in the business of creating reserves and should direct its attention to those aggregates, rather than focusing exclusively on interest rates.

Mr. Ellis said his conclusion that a lessened rate of monetary growth was called for in light of domestic conditions was fortified by developments in international finance. Given the unwillingness of Congress to adopt a fiscal program involving higher taxes, probably no action could be more effective in building confidence in the dollar than a Federal Reserve move to

a posture of less ease--or, as Mr. Brill had put it, the provision of "a clearer and stronger signal of restraint." Both at home and abroad there was both expectation and confidence that the Federal Reserve would demonstrate its sense of responsibility.

Mr. Ellis observed that, as Mr. Holmes had noted, the market had already discounted some firming by the System. The generality with which such a move was anticipated suggested that it would not have as extensive an impact on interest rates as might otherwise be feared. There was likely to be some further upward movement in short-term rates, but he suggested that the exposure to disintermediation was not as great as in 1966. The most interest-sensitive money had already fled--or had never returned to the financial intermediaries. The savings and loan associations had a stronger liquidity position and the Federal Home Loan Banks likewise were better prepared. And, after all, some reduced rate of loan expansion by the intermediaries was properly an objective of a less easy policy, as Mr. Partee had noted.

In that context, Mr. Ellis said, alternative B of the draft directives seemed to him to be clearly the appropriate choice. However, he would direct the Committee's attention to the differences in the proviso clauses included in the two alternatives. The clause in alternative A called, in effect,

for modifying operations if bank credit deviated significantly in either direction from current expectations. Past experience had demonstrated that such a proviso clause rarely came into play. The clause in alternative B, calling for modification of operations if necessary to moderate any unusual liquidity pressures, seemed to be the appropriate instruction at this point in light of the Committee's concern about possible increase in interest rates to levels that would put pressure on Regulation Q ceilings. Accordingly, if the Committee adopted directive language along the lines of Mr. Brimmer's suggestion, he (Mr. Ellis) would recommend including the proviso of alternative B. As he had indicated, however, he preferred alternative B as drafted for the directive.

Mr. Ellis concluded with the observation that he also would favor considering an increase in reserve requirements in January. Such an action would offer a more clear-cut signal of a policy shift than would the changes in market conditions and marginal reserves brought about by open market operations under an instruction to firm.

Mr. Robertson made the following statement:

> I read the latest economic signals as showing that business had rebounded quickly from the depressing effects of some major strikes and is now back on the track of a vigorous expansion. Indeed, that expansion is strong enough to carry along with it a continuing stream of price increases; and perhaps the only factors that keep it from being a full-fledged inflationary boom are the continued slackness of consumer spending and the indicated leveling of Federal Government outlays.

The worst remaining pressures seem to be concentrated in the first half of next year, according to the projections. If we can somehow struggle through that period, without permitting an acceleration of the wage-price spiral, the burdens on stabilization policy later in the year ought to be lighter. But in the interim, and particularly until some tax action comes along to help restrain demand, we are likely to be needing an orderly but determined firming of financial conditions.

In making that statement I intend to be referring to a broader set of concerns than simply interest rates alone. I recognize that interest rates have risen very much this year and are close to thresholds that might trigger some substantial disintermediation. I also recognize, however, that these rate movements have a sizable expectational component in them, and that they in fact have been accompanied for most of the year by large increases in the quantity of credit provided at those rates. I, myself, think we should focus more on the quantity and general availability of credit and less on price alone.

With that as an underlying policy objective, however, let me acknowledge that in fact the rate of credit expansion has slackened. Beginning at varying times in the late summer or fall, the rates of growth of reserves, money supply, bank credit, and nonbank savings intermediaries have all slackened significantly. Recently, even flows of market financing seem to be lightening somewhat. I assume that, by and large, these slowing credit flows are not accidental, or temporary, or the illusory by-product of some faulty seasonal adjustment, but a real reflection of the bite of the higher cost and reduced availability of funds. Moreover, apart from some temporary increases resulting from further Treasury financings, continuation or even accentuation of these slackened flows is projected for the rest of this month and next.

I have no desire to see money rates any higher then needed to achieve this moderation. Therefore, I think the Manager should operate to maintain about the currently prevailing money market conditions between now and our next meeting. If, however, demand proves stronger than projected, I would want the Manager to be prepared to act in a manner designed to moderate a further bulge in bank credit, even if money market conditions tighten slightly.

Mr. Robertson added that it seemed to him from the go-around that there was not a great deal of difference among the members' views on policy. In general, there appeared to be a preference for a modest move in the direction of greater restraint and a recognition that some restraint had already been accomplished. If the proposal was for a small further move toward restraint, he could concur in it; but if the move was to be as large as some members appeared to be suggesting, he could not. On the whole, he favored the directive language suggested by Mr. Brimmer, but would recommend one amendment to the second paragraph. To his mind, a reference to the firmer money market conditions that "have been achieved" because of the discount rate increase would carry the mistaken implication that those conditions had come about by design. He would prefer language reading "the firmer conditions that have developed in money markets."

Chairman Martin said he thought the Committee's discussion today had been highly useful and that the staff presentations had been excellent. It was his feeling that the Committee had in a sense been caught in a trap in recent months by the pattern in which events had unfolded. From the standpoint of economic considerations alone, it would have been desirable to adopt a firmer monetary policy a number of months ago. It had been clear then, however, that the overriding need was for a tax increase, and that a firming

of monetary policy would make Congressional action on taxes less likely. Moreover, the Committee's decisions had been taken under the shadow of the sterling problem. All things considered, it would have been a mistake to firm policy then, even though that was the most appropriate time for action in terms of the logic of the U.S. economic situation.

Now, Chairman Martin continued, it was clear that any tax increase would come later than it should, and perhaps too late. He certainly had done everything he could to help the Administration persuade Congress of the need for enactment of a tax increase in this session, but those efforts had been futile. There was no doubt that the System was faced with a serious problem at present.

From the over-all viewpoint, the Chairman said, the most important need was for an indication by the Committee that it was not unwilling to act to resist inflationary pressures. That, to his mind, was more important than the matter of the scale of the action, since many observers apparently had become convinced that the Committee would not move toward restraint under almost any conditions. The existence of that attitude, particularly abroad, was unfortunate.

However, Chairman Martin observed, it was clear that the Committee had to move delicately at this juncture in view of various potential problems. The possibility of disintermediation at financial institutions was one such problem, although he doubted

that it was as serious now as it had been in 1966. He was more inclined than some to accept the bullish projections for business activity in early 1968, but that, of course, was a matter of judgment. Unless decision makers in any area of policy were prepared to take some risks, they would never act. Perhaps monetary policy had an advantage in that respect because it could be reversed more easily than many other types of policy. The disinclination to take risks in connection with fiscal policy was evident at the latest Congressional hearings on a tax increase, where the sentiment seemed to be that the barn door should not be closed until the horse was seen coming out. To his mind, the economic statistics for the third quarter demonstrated that the horse of inflation not only was out of the barn but was already well down the road. To pursue the analogy, he did not think the horse could be returned to the barn by monetary policy, but it could be prevented from trotting too fast. As he had indicated, the main need at the moment was for the Committee to make clear by its posture that it recognized the nature of the current problem and was prepared to do its part in dealing with it.

Chairman Martin said that on reviewing the staff's draft directives before today's meeting he had concluded that either alternative was acceptable, as long as it was clear that the Committee's posture was one of firming. He was now inclined to

go along with the language Mr. Brimmer had suggested. Although relatively few members had formulated their preferred targets for policy in quantitative terms today, it was likely that their views on appropriate targets differed somewhat, with Mr. Francis probably favoring the most marked degree of firming. In any case, it seemed clear that the majority favored a modest move, in view of the uncertainties regarding disintermediation and other factors. The object was to probe sufficiently far toward firming to make it clear that the Committee was moving in that direction.

Chairman Martin then noted that Mr. Maisel had formulated for Committee consideration another version of the final sentence of the first paragraph, reading as follows: "In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions, including bank credit growth, conducive to sustainable economic expansion, resistance of inflationary pressures, and progress toward reasonable equilibrium in the country's balance of payments." His (Chairman Martin's) reaction to the suggestion was that it suffered from the weakness of attempting to specify too many objectives.

Mr. Robertson said he thought the proposed sentence also failed to make clear that the specific objective of the Committee's present policy was to attack inflationary pressures and the balance of payments problem. He would prefer the language Mr. Brimmer suggested.

Mr. Brimmer indicated that he also would prefer his original language, but was prepared to accept that suggested by Mr. Maisel.

Mr. Maisel said he had made the suggestion because it seemed important to him that the Committee keep in the forefront its main responsibility, which was to foster sustainable economic expansion, and not limit its policy statement to corollary responsibilities relating to prices and the balance of payments. In his judgment, the version of the sentence Mr. Brimmer proposed had far too narrow a focus.

Mr. Hayes remarked that he also would favor the version of the sentence that Mr. Brimmer had suggested, and it was his impression from the go-around that that was the view of the majority.

Chairman Martin then noted that Mr. Ellis had suggested that if the Committee adopted a second paragraph along the lines of Mr. Brimmer's proposal it should include the proviso clause shown in alternative B of the draft directives, calling for moderation of any unusual liquidity pressures, rather than the clause of alternative A, calling for moderation of any significant deviations of bank credit from current expectations. He asked whether use of the former proviso clause was agreeable with the Committee.

Mr. Swan said he saw the advantages of including the type of proviso shown under alternative B. However, he thought the directive would be weakened somewhat if, by omitting a reference to deviations of bank credit from expectations, no provision was made for moderating a possible upsurge in the rate of bank credit growth. Accordingly, he would favor including the substance of both proviso clauses.

Mr. Hickman remarked that use of Mr. Brimmer's suggested language for the first part of the second paragraph, together with a proviso including reference to "current expectations" for bank credit, might pose a problem with regard to the specification of those expectations. The blue book's discussion of the outlook for bank credit was formulated in terms of two sets of money market conditions, corresponding to alternatives A and B of the staff's directive drafts, but Mr. Brimmer's language was intended to call for money market conditions in between the two sets described in the blue book.

Mr. Hayes said he would prefer a proviso clause referring only to unusual liquidity pressures, for two reasons. First, possible pressures of that type were the main factor to which the Manager would have to be alert in carrying out firming operations under present conditions. Secondly, the likely course of bank credit was particularly uncertain at the moment.

In reference to Mr. Hickman's comment, Mr. Brill agreed that no bank credit projections were provided in the blue book for the money market conditions contemplated by Mr. Brimmer's proposed directive language. That might be taken as an argument in favor of confining the proviso clause to unusual liquidity pressures. Alternatively, the Committee could indicate its expectations for bank credit under the contemplated targets for money market conditions.

Mr. Holland remarked that since the money market conditions to be sought were in between those specified in the blue book for alternatives A and B, the specification of bank credit expectations might similarly be taken as in between those associated with the two sets of money market conditions.

Mr. Mitchell said he would favor including a reference to bank credit in the proviso. It was clear from the go-around that the Committee would be concerned if bank credit deviated significantly from expectations, particularly in an upward direction.

Mr. Holmes noted that the proviso clause shown in alternative A called for modification of operations if bank credit appeared to be deviating significantly--presumably in either direction--from expectations. He asked whether, if the Committee included the substance of that clause in the directive, firming operations were to be discontinued if bank credit appeared to be falling significantly short of expectations.

Mr. Robertson said he did not think the Committee would contemplate such a course if it included both proviso clauses; he agreed with Mr. Mitchell that the Committee's main concern was with upward deviations of bank credit. He would interpret the incorporation of both proviso clauses as calling for firming somewhat further if bank credit appeared to be exceeding expectations significantly, but not so far as to create liquidity problems.

At Chairman Martin's request, Mr. Holland read a version of a second paragraph for the directive incorporating the substance of both proviso clauses. Mr. Sherrill suggested a clarifying revision of language in which other members concurred.

With Mr. Maisel 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 industrial output and employment have rebounded following strike settlements in the automobile and other industries, and that prospects have heightened for more rapid expansion of over-all economic activity in the months ahead. Both industrial and consumer prices have continued to rise at a substantial rate. The imbalance in U.S. international transactions has worsened, partly because of weakening in the export surplus since midyear. Foreign purchases of gold have been large following the devaluation of the pound sterling. Bank credit expansion has lessened, with diminished bank buying of Government securities and continued moderate loan growth. Most interest rates have risen further in reaction to the British devaluation and Bank rate increase, the rise in

Federal Reserve discount rates, and waning expectations of enactment of the President's fiscal program. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resistance of inflationary pressures and progress toward reasonable equilibrium in the country's balance of payments.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to moving slightly beyond the firmer conditions that have developed in money markets partly as a result of the increase in Federal Reserve discount rates; provided, however, that operations shall be modified as needed to moderate any apparently significant deviations of bank credit from current expectations or any unusual liquidity pressures.

Mr. Maisel dissented from this action for reasons similar to those he had expressed in the go-around in explaining his opposition to alternative B of the staff drafts; and because, as he had indicated earlier, he did not favor the form of the statement of the Committee's general policy stance in the final sentence of the first paragraph.

Mr. Hayes said he had voted for the directive because he found it an acceptable compromise, although he would have preferred language that was a little more definite in its statement with respect to firming.

Mr. Swan commented that he would like to note before the meeting adjourned that, having participated in the daily telephone conference call for the last two weeks, he had been in a position to follow market developments and Desk operations closely. In his

judgment the Account Management had done an excellent job in coping with unusually difficult problems in the market.

Chairman Martin said he would caution everyone present today about the need to be especially careful to preserve the confidentiality of the Committee's policy decision. In view of recent events, including the waves of speculation in international financial markets, the System's actions were being followed extremely closely. It was important that the System let the market developments that resulted from its actions speak for themselves.

It was agreed that the next meeting of the Committee would be held on Tuesday, January 9, 1968, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

December 11, 1967

Drafts of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on December 12, 1967

ALTERNATIVE A

The information reviewed at this meeting indicates that industrial output and employment have rebounded following strike settlements in the automobile and other industries, and that prospects have heightened for more rapid expansion of over-all economic activity in the months ahead. Both industrial and consumer prices have continued to rise at a substantial rate. The imbalance in U.S. international transactions has worsened, partly because of weakening in the export surplus since midyear. Foreign purchases of gold have been large following the devaluation of the pound sterling. Bank credit expansion has lessened, with diminished bank buying of Government securities and continued moderate loan growth. Most interest rates have risen further in reaction to the British devaluation and Bank rate increase, the rise in Federal Reserve discount rates, and waning expectations of enactment of the President's fiscal program. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to sustainable economic expansion, recognizing the need for resisting inflationary pressures for both domestic and balance of payments purposes.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the firmer conditions that have developed in money markets since the increase in Federal Reserve discount rates; provided, however, that operations shall be modified as needed to moderate any apparently significant deviations of bank credit from current expectations.

ALTERNATIVE B

The information reviewed at this meeting indicates that industrial output and employment have rebounded following strike settlements in the automobile and other industries, and that prospects have heightened for more rapid expansion of over-all economic activity in the months ahead. Both industrial and consumer prices have continued to rise at a substantial rate. The imbalance in U.S. international transactions has worsened, partly because of

weakening in the export surplus since midyear. Foreign purchases of gold have been large following the devaluation of the pound sterling. Bank credit expansion has lessened, with diminished bank buying of Government securities and continued moderate loan growth. Most interest rates have risen further in reaction to the British devaluation and Bank rate increase, the rise in Federal Reserve discount rates, and waning expectations of enactment of the President's fiscal program. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resistance of inflationary pressures and progress toward reasonable equilibrium in the country's balance of payments.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to achieving somewhat firmer conditions in the money market; but operations may be modified as needed to moderate any unusual liquidity pressures.