CONFIDENTIAL (FR) October 31, 1966

TO: Federal Open Market Committee

FROM: Mr. Holland

Attached is a draft current economic policy directive for consideration by the Committee at its meeting tomorrow.

Also attached is a set of notes, keyed to the numbered lines of the draft directive. These notes represent an experimental effort to improve communication with the Committee regarding the staff's reasons for proposing certain language at particular points, including all points at which significant changes from prior language are suggested. This procedure will be followed in the future if the Committee believes that it is helpful.

Attachments

CONFIDENTIAL (FR) October 31, 1966

Draft of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on November 1, 1966

The economic and financial developments reviewed at this meeting indicate that over-all domestic economic activity is STILL expanding ~~vigorously~~, despite EVIDENCES OF SLACKENING IN SOME SECTORS OF THE PRIVATE ECONOMY ~~the substantial weakening in residential construction, uncertainties in equity markets, and a sharp increase in business inventories~~. WHILE PRICES OF SOME MATERIALS HAVE DECLINED RECENTLY, UPWARD DEMAND AND COST PRESSURES PERSIST FOR MANY FINISHED GOODS AND SERVICES. ~~Inflationary pressures are persisting and aggregate~~ BANK credit EXPANSION HAS SLACKENED AND EARLIER STRAINS IN FINANCIAL MARKETS HAVE ABATED ~~demands still remain strong~~. The balance of payments ~~continues to show a sizable liquidity~~ REMAINS IN deficit; ALTHOUGH CAPITAL INFLOWS INCREASED IN THE THIRD QUARTER THE TRADE SURPLUS DECLINED FURTHER. In this situation, and in light of the ~~new~~ fiscal POLICY MEASURES RECENTLY ENACTED BY CONGRESS ~~program announced by the President~~, it is the Federal Open Market Committee's policy to MAINTAIN MONEY AND CREDIT CONDITIONS CONDUCIVE TO THE RESTRAINT OF ~~resist~~ inflationary pressures and to THE RESTORATION OF ~~continue efforts to restore~~ reasonable equilibrium in the country's balance of payments.

To implement this policy, and taking account of THE CURRENT ~~forthcoming~~ Treasury financings, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining GENERALLY STEADY ~~firm but orderly~~ conditions in the money market; provided, however, that operations shall be modified, INSOFAR AS THE TREASURY FINANCING PERMITS, ~~in the light of unusual liquidity pressures or of~~ TO MODERATE any apparently significant deviations of bank credit from current expectations.

October 31, 1966

Notes on draft directive

(Parenthetical numbers refer to pages at which relevant discussions begin in green book, unless blue book is indicated)

Lines 1-6: The changes indicated in the first sentence are proposed because of signs of tapered growth or decline in the following areas: industrial production (II-6), retail sales (II-7), private residential and non-residential construction (II-10), orders for nondefense durable goods (II-13), and nonfarm employment (II-16). With the suggested general phrase on evidences of slackening, the previous list citing specific "areas of weakness" would no longer appear necessary. In addition, the recent recovery of common stock prices indicates a need to drop the earlier reference to uncertainties in equity markets.

Lines 6-8: Recent disparate price developments (II-20 and II-21) suggest that it would be desirable to replace the previous general reference to persisting inflationary pressures with a more specific statement, but one that still retains the general sense of inflationary overtones in the economy. Wage and collective bargaining developments (II-19) support a reference to upward pressures from costs as well as from demands.

Lines 9-10: Revision of the statement concerning financial conditions is required for factual accuracy, in light of developments in banking (I-5, III-1), Government securities markets (III-7), Federal agency markets (III-10), corporate and municipal markets (I-6, III-13), and money markets (blue book, 1).

Lines 11-13: In view of the recent disparate movements and sharp changes in the two measures of the balance of payments (I-8, IV-1), a simple interpretative statement, not referring to either measure specifically, appears appropriate here. It also seems desirable to mention the opposing tendencies in capital flows (IV-3) and the trade balance (I-9, IV-2), the former being evidence of effects of monetary policy in recent months, the latter reflecting the pressures of domestic demands for goods.

Lines 14-19: The indicated revision of the statement of the Committee's general policy posture is suggested for the following reasons: (1) to recognize the change in the general tone and character of economic conditions, as reflected in the revisions proposed in the preceding language of this paragraph; (2) to take account of the fact that some fiscal policy measures have been passed by Congress; and (3) to formulate the statement in terms that recognize the Committee's specific area of influence.

Line 23: Replacing "firm but orderly" with "generally steady" in describing the money market conditions to be sought would appear desirable because (1) even keel considerations presumably will be of greater importance in the coming period than in the recent one, and (2) the need for emphasizing the goal of "orderly" conditions has been reduced by the abatement of money market pressures (blue book, 1).

Lines 24-27: Deletion of the reference to "unusual liquidity pressures" is indicated because a period of strong seasonal pressures--including the September tax and dividend dates and the month-end interest payment date at nonbank depositary institutions--

has passed. With respect to the phrase, "any apparently significant deviations of bank credit from current expectations," the Board staff's credit proxy is projected to decline at an annual rate of about 2 per cent in November, assuming that money market rates and levels of net reserve availability fluctuate within the range of the last 4 weeks (blue book, 3).

If, to the extent consistent with an even keel posture, the Committee would like to foster somewhat greater strength in bank credit than implied by the staff projection, it might instruct the Manager to interpret "generally steady conditions in the money market" as referring to the somewhat easier conditions that developed in the latest two weeks of the period since the preceding meeting. If the Committee follows this course, the term "current expectations" in the proviso clause should logically be taken to mean a somewhat stronger bank credit performance in November than that projected in the blue book.