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, March 7, 1967, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Brimmer
Mr. Daane
Mr. Francis
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Scanlon
Mr. Shepardson
Mr. Swan
Mr. Wayne

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

Messrs. Clay and Irons, Presidents of the Federal Reserve Banks of 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, Craven, Garvy, Hersey, Jones, Koch, Partee, and Solomon, Associate Economists
Mr. Holmes, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Cardon, Legislative Counsel, Board of Governors
Mr. Fauver, Assistant to the Board of Governors
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. Hilkert and Strothman, First Vice Presidents of the Federal Reserve Banks of Philadelphia and Minneapolis, respectively
Messrs. Eisenmenger, Eastburn, Mann, Taylor, Tow, and Green, Vice Presidents of the Federal Reserve Banks of Boston, Philadelphia, Cleveland, Atlanta, Kansas City, and Dallas, respectively
Mr. Haymes, Assistant Vice President, Federal Reserve Bank of Richmond
Mr. Geng, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Kareken, Consultant, Federal Reserve Bank of Minneapolis

In the agenda for this meeting, the Secretary reported that advices had been received of the election by the Federal Reserve Banks of members and alternate members of the Federal Open Market Committee for the term of one year beginning March 1, 1967, and that it appeared that such persons would be legally qualified to serve after they had executed their oaths of office.

The elected members and alternates were as follows:

Alfred Hayes, President of the Federal Reserve Bank of New York, with William F. Treiber, First Vice President of the Federal Reserve Bank of New York, as alternate;

Edward A. Wayne, President of the Federal Reserve Bank of Richmond, with George H. Ellis, President of the Federal Reserve Bank of Boston, as alternate;

Charles J. Scanlon, President of the Federal Reserve Bank of Chicago, with W. Braddock Hickman, President of the Federal Reserve Bank of Cleveland, as alternate;

Darryl R. Francis, President of the Federal Reserve Bank of St. Louis, with Harold T. Patterson, President of the Federal Reserve Bank of Atlanta, as alternate;

Eliot J. Swan, President of the Federal Reserve Bank of San Francisco, with Hugh D. Galusha, Jr., President of the Federal Reserve Bank of Minneapolis, as alternate.

Upon motion duly made and seconded, and by unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until the election of their successors at the first meeting of the Committee after February 29, 1968, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, as the case might be, they would cease to have any official connection with the Federal Open Market Committee:

Wm. McC. Martin, Jr.	Chairman
Alfred Hayes	Vice Chairman
Robert C. Holland	Secretary
Merritt Sherman	Assistant Secretary
Kenneth A. Kenyon	Assistant Secretary
Arthur L. Broida	Assistant Secretary
Charles Molony	Assistant Secretary
Howard H. Hackley	General Counsel
David B. Hexter	Assistant General Counsel
Daniel H. Brill	Economist
Ernest T. Baughman, J. Howard Craven, George Garvy, A. B. Hersey, Homer Jones, Albert R. Koch, J. Charles Partee, Benjamin U. Ratchford, and Robert Solomon	Associate Economists

Upon motion duly made and seconded, and by unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Federal Open Market Committee after February 29, 1968.

Upon motion duly made and seconded, and by unanimous vote, Alan R. Holmes and Charles A. Coombs were selected to serve at the pleasure of the Federal Open Market Committee as Manager of the System Open Market Account and as Special Manager for foreign currency operations for such Account, respectively, it being understood that their selection was subject to their being satisfactory to the Board of Directors of the Federal Reserve Bank of New York.

Secretary's note: Advice subsequently was received that Messrs. Holmes and Coombs were satisfactory to the Board of Directors of the Federal Reserve Bank of New York for service in the respective capacities indicated.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on February 7, 1967, were approved.

Consideration then was given to the continuing authorizations of the Committee, according to the customary practice of reviewing such matters at the first meeting in March of every year, and the actions set forth hereinafter were taken.

Upon motion duly made and seconded, and by unanimous vote, the following procedures with respect to allocations of securities in the System Open Market Account were approved without change:

1. Securities in the System Open Market Account shall be reallocated on the last business day of each month by means of adjustments proportionate to the adjustments that would have been required to equalize approximately the average reserve ratios of the 12 Federal Reserve Banks based on the most recent available five business days' reserve ratio figures.

2. The Board's staff shall calculate, in the morning of each business day, the reserve ratios of each Bank after allowing for the indicated effects of the settlement of the Interdistrict Settlement Fund for the preceding day. If these calculations should disclose a deficiency in the reserve ratio of any Bank, the Board's staff shall inform the Manager of the System Open Market Account, who shall make a special adjustment as of the previous day to restore the reserve ratio of that Bank to the average of all the Banks. However, such adjustments shall not be made beyond the point where a deficiency would be created at any other Bank. Such adjustments shall be offset against the participation of the Bank or Banks best able to absorb the additional amount or, at the discretion of the Manager, against the participation of the Federal Reserve Bank of New York. The Board's staff and the Bank or Banks concerned shall then be notified of the amounts involved and the Interdistrict Settlement Fund shall be closed after giving effect to the adjustments as of the preceding business day.

3. Until the next reallocation the Account shall be apportioned on the basis of the ratios determined in paragraph 1, after allowing for any adjustments as provided for in paragraph 2.

4. Profits and losses on the sale of securities from the Account shall be allocated on the day of delivery of the securities sold on the basis of each Bank's current holdings at the opening of business on that day.

A proposed list for distribution of periodic reports prepared by the Federal Reserve Bank of New York for the Federal Open Market Committee was presented for consideration and approval.

Thereupon, upon motion duly made and seconded, and by unanimous vote, authorization was given for the following distribution:

1. The Members of the Board of Governors.
2. The Presidents of the twelve Federal Reserve Banks.
3. Officers of the Federal Open Market Committee.
*4. The Secretary of the Treasury.
*5. The Under Secretary of the Treasury for Monetary Affairs and the Deputy Under Secretary for Monetary Affairs.
*6. The Assistant to the Secretary of the Treasury working on debt management problems.
*7. The Fiscal Assistant Secretary of the Treasury.
8. The Director of the Division of Bank Operations of the Board of Governors.
9. The officer in charge of research at each of the Federal Reserve Banks not represented by its President on the Federal Open Market Committee.
10. The alternate member of the Federal Open Market Committee from the Federal Reserve Bank of New York; the Assistant Vice Presidents of the Federal Reserve Bank of New York working under the Manager of the System Account; the Managers of the Securities Department of the New York Bank; the Vice President of the Foreign Function having supervisory responsibility for operations; the Senior Foreign Exchange Officer of the Foreign Function; the Managers of the Foreign Department; the officer in charge, the Assistant Vice President, and the Adviser of the Research Department of the New York Bank; and the confidential files of the New York Bank as the Bank selected to execute transactions for the Federal Open Market Committee.
11. With the approval of a member of the Federal Open Market Committee or any other President of a Federal Reserve Bank, with notice to the Secretary, any other employee of the Board of Governors or a Federal Reserve Bank.

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* Weekly reports of open market operations only.

The Committee reaffirmed by unanimous vote the authorization, first given on March 1, 1951, for the Chairman to appoint a Federal Reserve Bank to operate the System Open Market Account temporarily in case the Federal Reserve Bank of New York is unable to function.

The following resolution to provide for the continued operation of the Federal Open Market Committee during an emergency was reaffirmed by unanimous vote:

In the event of war or defense emergency, if the Secretary or Assistant Secretary of the Federal Open Market Committee (or in the event of the unavailability of both of them, the Secretary or Acting Secretary of the Board of Governors of the Federal Reserve System) certifies that as a result of the emergency the available number of regular members and regular alternates of the Federal Open Market Committee is less than seven, all powers and functions of the said Committee shall be performed and exercised by, and authority to exercise such powers and functions is hereby delegated to, an Interim Committee, subject to the following terms and conditions:

Such Interim Committee shall consist of seven members, comprising each regular member and regular alternate of the Federal Open Market Committee then available, together with an additional number, sufficient to make a total of seven, which shall be made up in the following order of priority from those available: (1) each alternate at large (as defined below); (2) each President of a Federal Reserve Bank not then either a regular member or an alternate; (3) each First Vice President of a Federal Reserve Bank; provided that (a) within each of the groups referred to in clauses (1), (2), and (3) priority of selection shall be in numerical order according to the numbers of Federal Reserve Districts, (b) the President and the First Vice President of the same Federal Reserve Bank shall not serve at the same time as members of the Interim Committee, and (c) whenever a regular member or regular alternate of the

Federal Open Market Committee or a person having a higher priority as indicated in clauses (1), (2), and (3) becomes available he shall become a member of the Interim Committee in the place of the person then on the Interim Committee having the lowest priority. The Interim Committee is hereby authorized to take action by majority vote of those present whenever one or more members thereof are present, provided that an affirmative vote for the action taken is cast by at least one regular member, regular alternate, or President of a Federal Reserve Bank. The delegation of authority and other procedures set forth above shall be effective only during such period or periods as there are available less than a total of seven regular members and regular alternates of the Federal Open Market Committee.

As used herein the term "regular member" refers to a member of the Federal Open Market Committee duly appointed or elected in accordance with existing law; the term "regular alternate" refers to an alternate of the Committee duly elected in accordance with existing law and serving in the absence of the regular member for whom he was elected; and the term "alternate at large" refers to any other duly elected alternate of the Committee at a time when the member in whose absence he was elected to serve is available.

The following resolution authorizing certain actions by the Federal Reserve Banks during an emergency was reaffirmed by unanimous vote:

The Federal Open Market Committee hereby authorizes each Federal Reserve Bank to take any or all of the actions set forth below during war or defense emergency when such Federal Reserve Bank finds itself unable after reasonable efforts to be in communication with the Federal Open Market Committee (or with the Interim Committee acting in lieu of the Federal Open Market Committee) or when the Federal Open Market Committee (or such Interim Committee) is unable to function.

(1) Whenever it deems it necessary in the light of economic conditions and the general credit situation then prevailing (after taking into account the possibility

of providing necessary credit through advances secured by direct obligations of the United States under the last paragraph of section 13 of the Federal Reserve Act), such Federal Reserve Bank may purchase and sell obligations of the United States for its own account, either outright or under repurchase agreement, from and to banks, dealers, or other holders of such obligations.

(2) In case any prospective seller of obligations of the United States to a Federal Reserve Bank is unable to tender the actual securities representing such obligations because of conditions resulting from the emergency, such Federal Reserve Bank may, in its discretion and subject to such safeguards as it deems necessary, accept from such seller, in lieu of the actual securities, a "due bill" executed by the seller in form acceptable to such Federal Reserve Bank stating in substantial effect that the seller is the owner of the obligations which are the subject of the purchase, that ownership of such obligations is thereby transferred to the Federal Reserve Bank, and that the obligations themselves will be delivered to the Federal Reserve Bank as soon as possible.

(3) Such Federal Reserve Bank may in its discretion purchase special certificates of indebtedness directly from the United States in such amounts as may be needed to cover overdrafts in the general account of the Treasurer of the United States on the books of such Bank or for the temporary accommodation of the Treasury, but such Bank shall take all steps practicable at the time to insure as far as possible that the amount of obligations acquired directly from the United States and held by it, together with the amount of such obligations so acquired and held by all other Federal Reserve Banks, does not exceed $5 billion at any one time.

Authority to take the actions above set forth shall be effective only until such time as the Federal Reserve Bank is able again to establish communications with the Federal Open Market Committee (or the Interim Committee), and such Committee is then functioning.

By unanimous vote the Committee reaffirmed the authorization, first given at the meeting on December 16, 1958, providing for System personnel assigned to the Office of Emergency Planning, Special Facilities Branch, on a rotating basis to have access to the resolutions (1) providing for continued operation of the Committee during an emergency and (2) authorizing certain actions by the Federal Reserve Banks during an emergency.

There was unanimous agreement that no action should be taken to change the existing procedure, as called for by resolution adopted June 21, 1939, requesting the Board of Governors to cause its examining force to furnish the Secretary of the Federal Open Market Committee a report of each examination of the System Open Market Account.

Reference was made to the procedure authorized at the meeting of the Committee on March 2, 1955, and most recently reaffirmed on March 1, 1966, whereby, in addition to members and officers of the Committee and Reserve Bank Presidents not currently members of the Committee, minutes and other records could be made available to any other employee of the Board of Governors or of a Federal Reserve Bank with the approval of a member of the Committee or another Reserve Bank President, with notice to the Secretary.

It was stated that lists of currently authorized persons at the Board and at each Federal Reserve Bank (excluding secretaries and records and duplicating personnel) had recently been confirmed by the Secretary of the Committee. The current lists were reported to be in the custody of the Secretary, and it was noted that revisions could be sent to the Secretary at any time.

It was agreed unanimously that no action should be taken at this time to amend the procedure authorized on March 2, 1955.

Chairman Martin then noted that a memorandum from the Account Manager had been distributed under date of February 28, 1967, regarding the continuing authority directive relating to transactions in U.S. Government securities and bankers' acceptances.[1] He invited Mr. Holmes to comment.

Mr. Holmes said that three of the recommendations in his memorandum involved keeping as permanent features of the continuing authority directive changes that had been made during the past year, and the fourth involved a minor language clarification. First, with respect to section 1(a) of the directive, on July 26, 1966, the Committee had increased from \$1.5 billion to \$2.0 billion the limit on the amount that the aggregate Account holdings of Government securities could be increased or decreased during the interval between Committee meetings as a result of open market activity, and he suggested retaining the \$2.0 billion figure.

1/ A copy of this memorandum has been placed in the Committee's files.

Secondly, he suggested clarifying the language in section 1(b) describing the two limits specified on aggregate Account holdings of bankers' acceptances, in line with the manner in which that language had always been understood, by adding the phrase "whichever is the lower." The affected clause would then read:

> "provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed (1) $125 million or (2) 10 per cent of the total of bankers' acceptances outstanding as shown in the most recent acceptance survey conducted by the Federal Reserve Bank of New York, whichever is the lower."

Third, Mr. Holmes continued, section 1(c) had been revised on June 28, 1966, to remove the previous 24-month limit on the maturity of Government securities that could be acquired under repurchase agreements at times other than during Treasury financings. That action had been intended as a temporary measure. However, because the ability to buy securities of any maturity under RP's had proved, and was likely to remain, helpful, he recommended continuing it as a permanent feature of the directive. Finally, with respect to section 2 of the directive, he would recommend retaining the limit of $1 billion on special short-term certificates of indebtedness that the Federal Reserve Bank of New York could buy directly from the Treasury, in view of the possibility that the Treasury might have difficulty in managing its cash balances for some time to come. The limit in question had been increased to its present level from $500 million on November 22, 1966.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Open Market Account in accordance with the following continuing authority directive relating to transactions in U.S. Government securities and bankers' acceptances:

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent current economic policy directive adopted at a meeting of the Committee:

(a) To buy or sell U.S. Government securities in the open market, from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing U.S. Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account at the close of business on the day of a meeting of the Committee at which action is taken with respect to a current economic policy directive shall not be increased or decreased by more than $2.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

(b) To buy or sell prime bankers' acceptances of the kinds designated in the Regulation of the Federal Open Market Committee in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates; provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed (1) $125 million or (2) 10 per cent of the total of bankers' acceptances outstanding as shown in the most recent acceptance survey conducted by the Federal Reserve Bank of New York, whichever is the lower.

(c) To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the U.S., and prime bankers' acceptances with maturities of 6 months or less at the time of purchase, from nonbank dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities, obligations, or acceptances in 15 calendar days or less, at rates not less than (1) the discount rate of the Federal Reserve Bank of New York at the time such agreement is entered into, or (2) the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers' acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

2. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York to purchase directly from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommondation of the Treasury; provided that the rate charged on such certificates shall be a rate 1/4 of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases, and provided further that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed $1 billion.

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 February 7 through March 1, 1967, and a supplemental report for March 2 through 6, 1967. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Coombs stated that it was indeed a pleasure to report that conditions in the gold and foreign exchange markets had taken a turn for the better during the past month. The Treasury gold stock would be unchanged again this week and, perhaps more importantly, there had been some welcome relief from pressure on the London gold market. While speculative demand for gold remained at high levels, the flow of South African gold to London had been running 30 to 50 per cent above normal and a sale of nearly $30 million of gold by another country on the London market had further improved the supply situation. As a result, the market price had declined to $35.14 this morning, and the Pool took in $47 million in February and a further $10 million so far in March. That meant that the Pool now had $96 million on hand, which was the most comfortable margin it had had for a long while. How long the present situation would last depended upon balance of payments developments in South Africa; if they moved back into surplus from their present deficit they would withhold gold, and a gap in the supply would develop.

On the exchange markets, Mr. Coombs continued, sterling suffered a sinking spell during the middle of February, mainly owing to announcement of some very high Government spending figures for the coming fiscal year, but it recovered strongly at month-end. The consequent inflow of dollars to the Bank of England had enabled the British to clean up early in March the last remaining $100 million due to the Federal Reserve under the swap line, while short-term debt to the U.S. Treasury had also been completely liquidated.

As the Committee might recall, Mr. Coombs said, last July such short-term borrowing by the Bank of England rose to a peak of $1.5 billion. It had subsequently been reduced to a residual of $450 million still due to the Bank for International Settlements and the European central banks included in the sterling balance credit package negotiated last July. The British were hoping that March would be another good month, and if so they might succeed in cleaning up completely all of their short-term debt sometime this spring.

Mr. Coombs remarked that the French had moved back into small surplus during February. There might be some likelihood, however, that the Bank of France would rebuild its dollar balances to the extent of roughly $200 million before coming to the U.S. for gold.

More generally, Mr. Coombs said, he would like to note that at present, close to the end of the fifth year that the

System's swap network had been in existence, there were no drawings outstanding on either side of the ledger. He hoped it would be possible to maintain that situation for at least a few months.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System open market transactions in foreign currencies during the period February 7 through March 6, 1967, were approved, ratified, and confirmed.

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 open market operations in U.S. Government securities and bankers' acceptances for the period February 7 through March 1, 1967, and a supplemental report for March 2 through 6, 1967. Copies of these reports have been placed in the files of the Committee.

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

> As the written reports to the Committee indicate, the interval since the last meeting was characterized first by a period of rising interest rates and a money market atmosphere that was surprisingly taut in light of reserve availability, followed by a period of more comfortable money market conditions and generally declining interest rates. Shifting market expectations, as is so often the case, played a major role in determining the characteristices of each subperiod.
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> At about the time of the last Open Market Committee meeting a more cautious note was beginning to develop in the securities markets as many participants began to conclude that the earlier sharp decline in interest rates might have gone too far. Given the size of underwriter

inventories and the steady stream of announcements adding to the calendar of new corporate and municipal issues, some technical market adjustment was inevitable and, indeed, needed if inventories were to be cleaned out to make room for the new issues coming to the market. In addition, however, market participants began to reappraise the future prospects for monetary policy in light of Congressional testimony pointing to the likelihood of a strong economy in the second half of the year. Unfortunately, a firmer money market tone strengthened the belief that further monetary ease was unlikely, and some market participants even felt that the System might already have let monetary conditions begin to tighten in the light of prospective credit demands.

Open market operations attempted to head off the tauter money market conditions in line with the policy adopted at the last meeting, but were not notably successful in doing so until just before the Washington's Birthday holiday. This was so despite massive reserve injections, and a rapid rise in aggregate reserve measures. Actual reserve availability consistently fell short of projected levels; in each of the two weeks following the last Committee meeting we went over the weekend anticipating free reserves ranging from $80 to $200 million, only to see the estimates revised sharply downward after new data were received. The money market itself proved hard to judge as the funds rate on several occasions declined in response to open market operations only to snap back again after it was too late for us to supply additional reserves. It is perhaps small consolation, but many money market participants were as puzzled as we about the behavior of the market. After publication of a free reserve figure of over $100 million for the week ending February 22 many of the money market banks were asking themselves why they had been willing to bid up the funds rate in light of the availability of reserves in the banking system.

The securities markets, already reassured that the Federal Reserve intended to maintain comfortable money market conditions, were given further psychological impetus on February 24 by heavy Government trust fund purchases of securities, as the Treasury had to forestall a rise in the debt over the ceiling. And the

Board's action on February 28 to reduce required reserves then generated expectations of some moderate further easing of monetary policy.

The failure of Congress to act before March 1 on an increase in the temporary debt ceiling to $336 billion left the Treasury with the prospect that the public debt would be $1.5 billion over the ceiling on February 28. In order to avoid this the Treasury redeemed special nonmarketable debt held by the Civil Service Retirement Fund, the Federal Deposit Insurance Corporation, the Home Loan Banks, and the Exchange Stabilization Fund. In order to keep the trust accounts and the Home Loan Banks fully invested, $700-$800 million of marketable issues were purchased, including $233 million of coupon issues bought by the Trading Desk for the Federal Deposit Insurance Corporation and Social Security accounts. The details of these operations were spelled out in the written reports, and I would only comment here that they were carried out without causing undue repercussions in either market prices or expectations. This was mainly due to the Treasury's willingness to have us tell the market more about the size and character of the operation than normally has been done.

The Board's action on February 28 to lower reserve requirements added further to the stronger market tone and encouraged a better flow of funds in the capital markets. The move was generally interpreted as confirming the System's desire for continued monetary ease in light of the current slowdown of economic activity and, to most market participants, it indicated some further ease, designed to see the capital market through its peak pressure in March. It also eased concern about the possibility of market pressure in April when the speed-up of corporate tax payments occurs. The timing of the reserve injection through lower reserve requirements was well designed to coincide with expected reserve needs and so far has not complicated open market operations in the least.

After all the gyrations that took place during the interval between Committee meetings, the three-month Treasury bill rate wound up about 20 basis points below the level prevailing at the time of the last meeting. In yesterday's regular weekly auction there was some bidding for new three- and six-month bills at rates as low as 4.29 per cent, but average issuing rates were established at about 4.34 per cent for both issues, as tenders were cautiously spread over a wider than normal range in the wake of recent rate declines. Yields on most coupon issues maturing within 6 years were down 2 to 6 basis points over the interval, reflecting recent market strength. Longer-term Governments have also fallen about 15 to 20 basis points since February 23, but are about 4 to 6 basis points above their levels at the time of the last Committee meeting. I should also note, parenthetically, that the System was able last Friday to purchase $50 million coupon issues maturing within 5 years without much impact on market rates or market expectations.

Prices of corporate and municipal obligations declined quite sharply in response to the heavy demands placed upon those markets by heavy current offerings and a steadily mounting calendar of prospective flotations. New issues moved slowly in this environment, and upward yield adjustments of 20 to 40 basis points were made on most new issues before any significant demand emerged. Both markets improved fairly sharply in the wake of the change in reserve requirements, with corporate issues recovering about one-third of earlier price declines. A heavy supply of new issues is still scheduled for the month ahead, however, including about $1.1 billion corporates and $750 million municipals, and a sizable backlog of tax exempts remain in dealer inventories.

As the blue book[1/] notes, the bank credit proxy and reserve aggregate measures were very strong over the past four weeks. The credit proxy expanded at a 15 per cent annual rate compared with the 9 - 11 per cent rate expected at the time of the last meeting. For March the Board staff anticipates a 6 - 8 per cent average rise in the credit proxy and a 10 - 12 per cent rise from the beginning to the end of the month. Projections at the New York Bank center near the upper end of these ranges.

Looking into the period ahead, I would agree wholeheartedly with the blue book statement that

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

"the difficulties in specifying consistent money market relationships are compounded by the uncertain effects of the reserve requirement reductions." And, it should be added, by the uncertainties involved in individual interpretations of current economic and credit developments, by the state of mind of various classes of market participants, and by international developments. I would agree that substantial free reserves may be needed at times to keep the funds rate averaging a little under 4-3/4 per cent, unless country banks put the funds released by the reserve requirement change to work more quickly than normally would be the case. But I expect that persistent free reserves, even of moderate size, will be interpreted as confirming the reserve requirement change as a moderate move towards further ease. Expectations may consequently play a major role in determining the course of interest rate developments, and also the rate of growth of bank credit. I am afraid that we will have to wait and see how these variables interact on a continuing basis. While I am by no means sure that it is possible to predict the relationships among reserves, credit, and interest rates over the next month, I have nothing constructive to add to the thorough discussion in the blue book. Open market operations will undoubtedly have to be flexibly adapted to emerging developments, and I hope that members of the Committee will indicate the priorities they would attach to the different variables with which we are usually concerned.

The Treasury is auctioning today $2.7 billion June tax anticipation bills, its last cash financing of the fiscal year. There should be few problems with the issue, and last night the market was anticipating an average issuing rate of about 4.30 per cent, with the 50 per cent tax and loan credit estimated to be worth about 15 basis points to commercial banks. Because the issue had to be postponed until Congress acted on the debt ceiling and since the Treasury lost cash as the result of the switch of trust funds out of special issues into market issues, the Treasury's cash balance is at a low ebb, and some borrowing from the System appears likely over this coming weekend and perhaps before. Additional borrowing from the System may be necessary in early April. While infrequent Treasury borrowing should not be a major cause of concern to the System, more frequent recourse to Federal Reserve credit could, if it occurs, be a source of trouble in managing the reserve supply. One can only hope that the next round of Congressional action on the debt ceiling, which will have to take place before June 30, will give the Treasury greater flexibility in managing its cash position than it has had in the past several months. I should also note that the Federal National Mortgage Association is expecting to announce tomorrow morning an issue of participation certificates, of which the bulk will mature within 5 years and only a modest amount will be long-term.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period February 7 through March 6, 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. Partee made the following statement on economic conditions:

Last Friday's Wall Street Journal reported optimistically that Government analysts see "silver linings in /the present/ economic storm clouds." But I, for one, must admit to failure on this score. It seems to me that virtually all of the economic news that has become available since the last meeting of the Committee is bearish--ranging from moderately to substantially so. And I do not think that recent unfavorable developments can be accommodated within the Administration's economic model described in some detail to you four weeks ago. In my view, if the economy is not now in an actual downturn, it very soon will be.

That is also the implication of the staff GNP projection for the first half contained in the green book.[1] A current dollar GNP expansion of $5 billion per quarter would bring almost no further gain in real output of goods and services, and would be consistent with a decline in industrial production over the period of around 5 per cent. With continued substantial expansion in industrial facilities, the factory utilization rate could drop below 85 per cent by midyear; and unemployment, despite slower growth in the labor force, could show an appreciable rise.

In this situation, some dampening in the upward movement of prices and wages certainly would be expected. But existing pressures to obtain higher wage rates are exceptionally strong and, given the unfavorable impact of declining output on productivity, unit labor costs in manufacturing would be likely for some time to show substantial further increases. Under these conditions, a sharp decline in corporate profits would be probable. In turn, lower profits and reduced operating rates could soon take the steam out of business capital spending plans. Thus, in the private sectors, we seem to have all of the ingredients of a full-fledged business recession.

It may be that my gloomy prognosis is exaggerated, but the signs of recessionary tendencies in the economy over recent weeks are unmistakable. Of greatest concern to me is the continuing dramatic weakness in consumer goods demand. Total retail sales were essentially flat from June through January; and allowing for price increases, there was a decline in physical volume. February appears to have shown a further drop, judging from the weekly figures, although unusually bad weather undoubtedly was a factor. The most pronounced weakness has been in new car sales, which declined sharply further to a 7 million annual rate in February, but many other retail lines have also shown declines or little growth. Excluding autos, the balance of retail trade increased very little after mid-1966; dollar volume in January was no higher than last June.

Personal income has continued to expand rapidly thus far, on the other hand, so that the rate of personal

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

saving appears to have moved sharply upward. Such a sharp adjustment in the savings rate is unusual but not unprecedented; a similar rise occurred in 1956, when new car sales dropped back from the 1955 high. Then, as now, a sizable part of the savings increase was reflected in reduced use of instlament credit. Nevertheless, the 7 per cent savings rate projected for the first half looks high relative to other recent years. Perhaps consumers will spend more freely in the months ahead, although if the environment is one of layoffs and shortened workweeks, one would not expect a buoyant buying psychology. And it should be noted that, even with the expectations of substantial future income gains shown in recent consumer surveys, buying intentions have not been strong.

The slackness in retail sales has extended and accentuated the problem of accomplishing needed adjustments in business inventories. Despite a one point drop in industrial production, manufacturers' inventories increased further in January, by about the same high $12 billion annual rate that characterized the last half of 1966. Over the past nine months, such stocks have increased by one-eighth while shipments have shown only modest further growth. Much of the increase in stocks--over 40 per cent--is accounted for by the defense and business equipment industries, but here too inventories have risen much more sharply in recent months than have order backlogs and shipments. The remainder of the inventory expansion had centered in other durable goods lines until recently, but in December and January there were substantial increases in holdings of nondurable goods.

The result of the inventory buildup has been a sharp rise in manufacturing stock-sales ratios, to the highest levels since 1961. As an indication of the dimensions of the problem, restoration of the ratios prevailing during 1965 and early 1966--given continuation of recent levels of shipments--would require an actual cutback in manufacturing inventories--not just reduced accumulation--amounting to $7 billion. In wholesale and retail trade, also, inventories have increased considerably more rapidly than sales over the past year; to restore the relationship between distributors' stocks and retail sales that prevailed in late 1965 would have required, as of year-end, an inventory liquidation of $2-1/2 billion. It seems unlikely that reductions of these magnitudes are in prospect. Inducements to hold inventories may well be greater now than before, and any future increases in sales will, of course, reduce the size of needed corrections. But it also seems unlikely that the corrections can be made without major production cutbacks. In sum, I believe that these figures indicate that the potential is there for a much larger and more extended inventory adjustment than is contemplated in most current GNP projections.

There are, of course, major prospective supports for the economy that should help keep an inventory adjustment from getting out of hand. State and local expenditures and consumer outlays for services continue to rise at a rapid rate. Residential construction shows every prospect of increasing as the year progresses, though the recent pickup in housing starts probably should be discounted in view of the very large seasonal adjustment factors applied at this time of year. And the recent surveys of business capital spending plans, although showing a leveling off in outlays, hold out some hope that a substantial decline will not develop. We have just learned, on an extremely confidential basis, that results of the latest Government survey indicate a smaller year-to-year increase than do recent private surveys, and with no further gain during the first half from the fourth quarter 1966 rate.

The major factor offsetting developing weaknesses in the private economy, however, continues to be the prospect of rising Federal outlays for defense. There is already some speculation that defense spending may rise more than projected in the January budget, although I have nothing new to offer on this score. But we have estimated the full employment fiscal implications of existing budget projections, taking fourth-quarter unemployment and a 4 per cent real growth rate as the basis for our calculations. This shows a rise in the full employment deficit from an annual rate of about \$5 billion in fourth quarter of 1966 to an average of nearly \$7 billion in the first half of this year. If the tax increase goes through, there would be a marked drop in the full employment deficit in the second half. But if the tax increase is not approved, and assuming an increase in social security benefits only about half that proposed--both seem increasingly likely prospects--the full employment deficit would rise slightly further in the second half, to \$8 billion or a little more.

Continuation of a deficit even of this size probably would not fully counterbalance weaknesses in the private sector--certainly it has not offest the recessionary tendencies of recent months--but it should provide important stimulus once the major impact of the inventory adjustment has been absorbed. Further, the automatic stabilizing features of the tax system will be cushioning any slowing in income flows; past relationships suggest that one-third to one-half of the shortfall in incomes below full employment levels will be compensated for by lower Federal tax accruals. Finally, the cumulative impact of easier money will serve to bolster the economy, not only through its effect on construction but also by tipping the scales in favor of marginal spending decisions in a wide variety of markets.

These considerations lend strong support to the view that any downward movement in the economy will be relatively shallow and short-lived. Nevertheless, near-term prospects for the next six months or so are distinctly unfavorable, and it must be recognized--as Mr. Mitchell commented at the last meeting--that there is usually more certainty in a short-term forecast than when we look further ahead. Accordingly, I would recommend a fully accommodative monetary policy for the present--one that is easy enough to assure the ready availability of funds at gradually falling interest rates in all sectors of the credit markets.

Mr. Brill made the following statement concerning financial developments:

The turbulence in financial markets over the past four weeks has been pretty thoroughly reviewed in the green book, the blue book, and the Manager's report; I'll resist the temptation, therefore, to indulge in additional post-mortems. By and large, we've gotten back to, or a shade easier than, the money market conditions prevailing at the time of the last meeting, but we still have some distance to go in restoring the capital market conditions of early February. Long-term market rates are still higher than at that time--some significantly so--and the prospective volume of private and public demands for long-term funds is larger. And while expansion of reserves and bank credit in February was greater than anticipated earlier in the month, banks have used the reserves provided to increase liquidity rather than to encourage expansion of customer loans.

As we look to the weeks ahead, the question confronting monetary policy formulation is less one of the appropriate direction of policy than of the extent to which this direction should be pursued. The near-term economic outlook, as Mr. Partee's analysis makes clear, is bleak. Prospects are not only weaker than the sluggish pattern projected in the Administration's model, but even weaker than the staff's own earlier projection. Disquietingly, this let-down in the pace of U.S. expansion comes at a time when several other countries are already in, or seem headed for, economic slowdown.

It seems doubtful to me that we can bank on self-correcting forces to forestall or curtail a downturn here at home. A resurgence of consumer spending may be a possibility, but--along with Mr. Partee--I wouldn't rate the odds very high in an atmosphere of declining production, reduced workweeks, and rising unemployment. And while the possibility of additional fiscal stimulation probably deserves higher odds, until fiscal talk is translated into specific expenditure and tax programs, such a possibility must remain--as it did most of last year--too weak a reed on which to base current monetary policy decisions. At the moment, then, there doesn't seem much alternative to continuing to press for easier financial conditions.

In deciding just how much easier, the first task is to assess what's been accomplished to date. Clearly the turn in policy last fall was timely, but we must guard against indulging in self-congratulation just because bank credit expansion over the past three months has proceeded at an annual rate of between 11 and 12 per cent. You will recall that the staff's projection of a bank credit growth rate consistent with the Council of Economic Advisers' model of GNP averaged about 9 per cent over the whole of 1967. Within that average, it was expected that credit expansion would be larger in the first half of the year than in the second, since we anticipated very large financing demands from business to restore depleted liquidity and to meet heavy tax payments. And within the first half, we suspected that financial flows would be large but would taper off before mid-year.

I won't pretend that we had any specific numbers in mind for bank credit expansion on a month-to-month basis, since our analytic tools are still far from competent to project for such short periods the expansion rate required to move back toward a full-employment economy. On balance, however, the order of magnitude of bank credit expansion since November does not seem far out of line with our chart show specifications as to what would have to accompany the CEA's model of GNP.

But since the economy is moving much more sluggishly than the CEA model, it may well be that what we've accomplished so far in the way of providing bank credit is barely adequate--and possibly inadequate--to provide the financial stimulation the economy needs. Certainly it does not seem to have achieved as yet what the economy needs in the way of borrowing terms and conditions to finance a really vigorous housing recovery; the results of the Reserve Banks' survey of mortgage flows indicate some general loosening of fund availability, but no gushing of credit into the housing area such that would suggest an acceleration of housing activity beyond that built into our model. And corporate borrowing costs--at banks and in the capital markets--are still high at a time when business capital spending and capital spending plans are being pared. Overall, then, I'm not so impressed by two-digit bank credit growth numbers as to feel that we've done all we can or all we have to do.

In determining how much further we might have to go, let me raise another warning signal--this against the danger of misconstruing the staff's projections of bank credit expansion, as given in the blue book and in our weekly perspective tables. It should be emphasized that these projected rates of bank credit growth are not "full-employment" estimates. Rather, they are crude estimates of the results for bank credit of a short-run interaction between a specified monetary policy and the real economy as projected in the green book. When we project, as we did in the current blue book, that unchanged money market conditions would likely accompany an increase in the credit proxy in March at an annual rate of 6 to 8 per cent with real expansion in GNP running at a negligible rate, we are not suggesting that this is the appropriate bank credit increase to help restore the economy to a 4 per cent rate of real growth. Nor are we suggesting that the somewhat easier money market conditions called for in alternative B of the directives[1/]--conditions we estimate could result in a bank credit expansion rate of at least 10 per cent in March--are sufficient in themselves to stimulate return to target rates of growth in real GNP.

We recognize that the appropriate course for the staff would be to specify both the credit conditions and the rate of credit expansion needed to help turn the economy away from an impending recession and put it back on a path toward full employment. The sad fact is that we can't--at least not on a 3 or 4 week basis. It would be silly for us to pretend that our knowledge of the interaction of financial variables with non-financial developments is as yet adequate to such an assignment.

The best we can do at the moment is to advise the Committee--as we do in the blue book--that maintaining present money market conditions, with long-term rates still undesirably high, would likely be associated with a bank credit expansion of about 6 to 8 per cent, and that pressing toward somewhat easier financial market conditions should be accompanied by a larger bank credit expansion, on the order of 10 per cent or more. But if somewhat easier market conditions do _not_ result in a more vigorous credit expansion, we would construe this as a signal of greater than expected weakness in the economy, calling for even easier market conditions.

In choosing among these policy alternatives, let me suggest that it is not too soon for the Committee to index its concern for the softening economic situation, and to act thereon. First, I would propose for Committee consideration a change in the wording of the first paragraph of the draft directive, substituting, in the last sentence of that paragraph, some alternative wording

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1/ Alternative draft directives submitted by the staff for Committee consideration are appended to these minutes as Attachment A.

which recognizes sagging economic prospects. Instead of ". . . fostering . . . conditions conducive to noninflationary expansion . . ." we might consider language such as " . . . fostering . . . conditions to combat recessionary tendencies . . ."

Next, I would recommend adoption of alternative B for the second paragraph, or some variant that left room for prompt action by the Desk to accelerate reserve provision if bank credit expansion appeared to be falling short of projections over the next 4 weeks, but indicated less concern if expansion should exceed the projections. The guide to reserve provision should in the first instance come from the market, and in particular from an objective of achieving money market conditions that permit and encourage a continuing declining trend in long-term rates, even in the face of the prospective volume of public and private capital market financing. A "one-way" proviso such as in alternative B would guard against an arbitrary limitation on the Manager's latitude to take the steps necessary in achieving the desired rate trends. An asymmetrical proviso is not unprecedented; the Committee operated with such a directive--then pointed toward the possibility of greater restraint--on a number of occasions last spring and summer.

Finally, after a decent interval--so as not to imply a sense of panic at the Fed--I would suggest the desirability of considering a reduction in the discount rate. Perhaps the next reduction should be only 1/4 of 1 per cent, which would leave financial market participants fully aware of the possibility of more to come if and when needed, rather than suggesting that the Fed had moved to another frozen position. Such a package of System actions seems to me appropriate to the emerging economic situation.

Mr. Hickman asked whether Mr. Brill would explain what timing he had in mind in connection with his comments on possible discount rate action. In particular, was he suggesting a change in the discount rate between now and the next meeting of the Committee?

In reply, Mr. Brill said he did not have a specific recommendation on the timing of a discount rate change in mind. A number of factors would have to be considered: one concerned the way in which developments in short-term markets proceeded; the three-month bill rate recently had dropped below the discount rate, but not by as much as 25 basis points as yet. Another factor was the desirability of avoiding undue rapidity in a sequence of Federal Reserve actions, since that might lead to more widespread concern than desirable about the System's assessment of the economic outlook. Perhaps a change some time around or after the next Committee meeting would be appropriate.

Mr. Mitchell noted that the GNP projections in the green book suggested that disposable income was rising rapidly in the first quarter and that the personal saving rate would reach the abnormally high level of 7 per cent and remain at that level in the second quarter. While he agreed that the kind of economic environment described was not one in which an upsurge in consumer spending could be expected, he wondered whether there was not significant doubt about the projection that so high a rate of personal saving would be sustained for two quarters.

Mr. Partee agreed that it required some stretching of the imagination to expect the savings rate to remain at 7 per cent for two quarters. Of course, personal income might well rise less than projected in the second quarter and the savings rate go down on that account. The staff had estimated the income increase at the rather low annual rate of 4 per cent, allowing for no appreciable increase in employment and only the normal rise in wages and salaries, but it was possible that actual income growth could be still weaker. He pointed out, however, that there had been periods in the past in which the savings rate had remained at a high level for some time. In particular, the rate had been stable at a level above 7 per cent from the second quarter of 1953 through the first quarter of 1954--a period leading into and encompassing the early part of the 1954 recession. In 1957 and 1958 also, the savings rate fluctuated around 7 per cent, although it was not as stable then as in 1953 and 1954. There was a sharp rise in the savings rate in 1956 much like that in recent quarters, followed by two years of little change--first because spending was weak and then because income was weak.

Mr. Brill added that in his judgment the odds favored a lower savings rate than projected, but it was more likely to result from weaker performance of income than from a rise in spending.

Mr. Maisel asked whether the expectation of little further increase in plant and equipment spending might not imply an actual reduction in the capital spending components of GNP, since producers' durable equipment included autos.

Mr. Partee replied that it probably did. He added that the producers' durable equipment item included certain other outlays not included in the plant and equipment figures--such as oil-well drilling--and he did not know whether the expansion expected there was strong enough to offset the automobile decline. In any case, the latest plant and equipment estimates showed no increase from the fourth quarter of 1966.

Mr. Swan referred to Mr. Brill's suggested change in the first paragraph of the draft directive, and asked what implications the change might have for the last clause of the affected sentence, relating to the balance of payments.

Mr. Brill replied that he thought the Committee still had to recognize that the balance of payments deficit remained a problem.

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

> The news on the balance of payments that has developed since the Committee's last meeting can be quickly summarized. Disappointingly, in view of the behavior of U.S. industrial production, imports were still rising through January though less rapidly than up to the middle of last year. Gratifyingly, outstanding bank credit to foreigners declined considerably in January. U.S. banks' borrowings from the Euro-dollar market have not changed much in the past few weeks, and so they still stand at a level about $1 billion below the mid-December peak.

None of these bits of news calls for revaluation of the outlook ahead. We are still projecting an absolute decline in imports during coming months as domestic inventory accumulation slows. On the other hand, the January reflow of bank credit and the February stability in use of Euro-dollar money by U.S. banks are by no means inconsistent with the possibility that later we may see outflows of both sorts.

The balances owed by U.S. banks to their branches abroad, after dropping by $1 billion from mid-December to the end of January, still stood last week at a level $1-1/2 billion higher than a year ago. Last summer and autumn when these balances were rising rapidly, Euro-dollar rates moved up a good deal more than British and German money market rates, under the pull of the bidding by American banks. Then when the American banks let a sizable chunk of the money they had taken from their branches run off, Euro-dollar rates fell sharply, and in fact moved down relative to sterling money rates enough to stimulate a considerable flow of funds into sterling. During February the movement of funds was small and rates were level or rising a bit. Now, with Federal funds easier in our markets than they were two weeks ago, we may see a further return of money from U.S. banks to the Euro-dollar market.

I will come back later to the policy implications of this outflow. I should like first to make some comments on recent monetary policy developments in Germany and Britain, the second and third largest economies of the Western world.

At this distance it is difficult to judge whether these two economies, after half a year or so of declining industrial production, are already getting in position for an upturn or not. British monetary policy remains cautious.

The British Government is planning on a considerable increase in government expenditures, but private investment prospects are so weak that most people predict only a slow recovery this year from the recession Britain has been having since last summer. The British may reasonably hope to keep their import growth slow, and they will try to get some benefit in export growth out of hoped-for economic expansion in the rest of the world.

German policy also looks pretty cautious still, though it has eased a great deal since last summer. To the outsider, this caution looks misplaced, with Germany's export surplus shockingly large by now, while excess pressures on German resources are probably less now than at any time in the last ten years, and prices are virtually stable.

Can we learn any policy lesson from British and German caution? If the United States were another middle-sized country, instead of having a GNP six times Germany's and more than double the whole Common Market Community's, we ought to be following their examples. A country with as serious a drain on its gold and IMF reserves as we will probably be having this year ought to be moving cautiously in monetary policy, letting other countries take the lead in promoting expansion. We might hope, for example, that a new advance in Germany would add momentum to European expansion in general and in that way foster continuing growth of world trade. But the size and predominance of the United States impose on it a responsibility to maintain its own economic growth, in a noninflationary way, in the world's interests as well as its own.

This being so, what can be said about using monetary policy in one way or another to help ease our balance of payments problem? There are various prescriptions to choose from, all palliatives, not cures.

The first prescription is to be as cautious as possible about letting interest rates decline, with the justification that we may thus stave off as long as possible large gold drains or the necessity of drawing on our credit line with the IMF. Under present circumstances, this seems to me wrong advice, not only because this policy might put undue limitations on domestic monetary action, but also because it is not the course of true prudence internationally. The main issue involved, given the existence of the IET and the voluntary programs, is whether monetary policy should try to postpone what may well be an inevitable reflow of more of the Euro-dollar funds U.S. banks have been using. My own view is that the course of wisdom is to let this reflow of Euro-dollars proceed sooner rather than later. We ought to be taking some of the pressure while seasonal factors are favorable in the first half of the year, while imports are falling off as we hope they will be soon, and while we are still many months away from the necessity of changing the Federal Reserve note gold reserve requirement. The balance of payments is still sick, and Administration policy makers should not have that fact disguised from them. We should be spreading out our reserve losses, not piling up IOU's to the future, lest some day an overwhelming mass of claims be thrown at us all at once and bring a crisis of confidence in the dollar. For such reasons as these a policy of inhibiting declines in U.S. interest rates now ought to be unacceptable as a balance of payments palliative.

An alternative prescription for how to live through a time of difficulties in the balance of payments can be written in various ways. The advice might be to avoid so much bank credit expansion that barriers to outflows set up by the voluntary program would break down. Or, with a strongly expansionary monetary policy, the advice might be simply to slow down as soon as signs appear of new inflationary pressures. What advice can be given depends on what monetary policy is adopted. No quick solution of the balance of payments problem is available to this Committee, and its decision today should be based, I submit, solely on appraisal of the current domestic situation and judgments about the strategy and tactics best suited to fostering renewed economic expansion of a noninflationary character. I could not play down immediate balance of payments considerations in this way if a crisis of confidence in the dollar were already blowing up. I would not play them down if the domestic economy were heading toward a new boom, with growing pressures on capacity. But that is not the situation now.

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:

When we met four weeks ago I commented on the low "visibility" of the business situation and especially on the apparent sharp contrast between shorter-term and longer-term prospects. Nothing has happened in the interim to diminish the uncertainties, and the contrast in question is, if anything, even sharper. The expansion appears to have slowed somewhat more than had been expected, probably in large part because consumer spending has been even less buoyant than seemed probable a month ago. The January survey of consumer buying intentions does not suggest an early upsurge in consumer outlays--although it should be added that it also does not point to any further significant weakening.

There is, of course, still a risk that the recent weakening might cumulate and bring about a general deterioration in the business climate. Indeed, the fact that inventory accumulation continued strong in January and that inventory-sales ratios rose is one element that I find worrisome. But I think the more likely development is a gradual return to more rapid economic growth later in the year. General business sentiment has not deteriorated. It seems probable that residential construction, which already appears to have turned the corner, will revive strongly. At the same time I believe it likely that fixed investment spending will not turn down but will continue to grow slowly, the uptrend of Government spending will continue, and consumption outlays will regain some of their earlier vigor, helped by the sizable current and prospective gains in personal income.

Unemployment has remained close to its recent low point. There may be a tendency for corporations to hold on to their workers in the expectation that output will soon be moving up again. There is every likelihood that we shall be confronted with excessive wage settlements in the coming months, even if productivity gains should recover somewhat from their recent slow pace. And while price pressures have subsided with the slackening of aggregate demand, any resurgence of demand pressures in the fall, coupled with a cost push, could provide a climate conducive to renewed sharp price gains.

Balance of payments developments, though not as unfavorable as in the fourth quarter of 1966, continue to give cause for serious concern. Excluding special transactions, the January liquidity deficit was possibly at a seasonally adjusted annual rate of nearly $2 billion, and preliminary February data indicate a worsening of the deficit. The trade surplus remains far below what is needed to take care of our various obligations abroad. We should not lose sight of the great risk to our payments position that would result from any resurgence of inflationary pressures.

On the credit front, I am impressed by the strong growth in total bank credit of the past three months. It has, of course, been a useful development, coming on top of the stagnation or decline in credit in the September-November period. While further growth would be welcome, there could be some risks in a long-continued expansion at the recent rapid pace. Much of the expansion has occurred in bank investments rather than loans. While the banks have been able to rebuild their liquidity to some extent, I think that most banks hope to progress further in this direction and therefore tend to retain a cautious attitude toward lending. The sluggishness of aggregate bank loans in February as compared with January may be attributable in part to the January tax speed-up program. Most banks in our District seem to feel that underlying loan demand remains quite strong, except in the consumer loan area; and of course current credit demands in the capital markets are at a very high level.

Since our last meeting market interest rates have swung rather widely in response to changing expectations. The unwarranted fear that Federal Reserve policy might be tightening was pretty well dissipated about ten days ago, and the reversal was clinched by the announcement of the reduction in reserve requirements for savings and certain time deposits. Not unexpectedly, the latter development was regarded rather widely as a significant move toward easier money; and the effects in the capital markets were quite pronounced. Feeling as I do about the likelihood of an acceleration of economic expansion later in the year, with a probable intensification of inflationary pressures, I would hope that we would not give these market interest rate declines a strong further push through open market operations. I would like to regard the reserve requirement reduction as in large part a substitute for open market purchases that would otherwise have been required--although, as I have already indicated, it has inevitably had important psychological effects. I have no objection to such effects, provided they don't generate excessive expectations of still further easing.

For the next four weeks I think we would do well to maintain about the present degree of ease in money market conditions, with a Federal funds rate of 4-1/2 to 5 per cent and a bill rate probably fluctuating somewhat under the discount rate. In terms of the reserve figures it is hard to predict what will be needed; but many of the

> reserves released by the requirement reduction may tend to pile up in the form of excess reserves, so that a moderate free reserve figure--say $50 to $150 million--may be consistent with the money market objectives I have suggested. However, there are enough uncertainties so that the Manager will need at least the usual degree of flexibility. I think he should resolve doubts on the side of ease; but I would like to see the directive include the existing two-way proviso and would not push credit expansion too rapidly--say at anything close to the 15 per cent February rate--even if market interest rates should show signs of moderate firming.
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> The staff's draft directive with alternative A as the second paragraph seems satisfactory. However, I think I could also accept alternative B if "somewhat" were changed to "slightly" and if the proposed one-way proviso were replaced by the two-way proviso of alternative A. I would suggest that the first paragraph include the clause "to combat weakening tendencies in the economy." Use of the term "recessionary tendencies," as Mr. Brill proposes, might be somewhat too alarmist under present circumstances.

Mr. Francis commented that economic activity had been on a plateau in recent months. Government outlays, both Federal and local, continued to grow while the private sector recorded some declines. Retail sales, industrial production, and construction were down from their 1966 peaks, and real incomes had been rising at a reduced rate. Although total employment had continued to rise, the average workweek had declined. The situation of shortages, bottlenecks, and speculative purchases of last summer had been replaced by rapid involuntary buildup of inventories threatening to cause further cutbacks in production. Demand-pull influence on prices had declined.

With the advantage of hindsight, Mr. Francis said, it appeared that restrictive monetary actions were appropriate from the spring of last year to the fall. Demands for goods and services were in excess of the economy's ability to produce, and there was a pronounced rise in prices. From April to November, member bank reserves, demand deposits, and money declined; interest rates rose on balance, and the growth in the demand for goods and services slowed to a more nearly sustainable rate.

In November, Mr. Francis continued, the Committee became concerned that monetary conditions might become too restrictive, especially since monetary action has a lagged effect, and a policy was adopted to relax the monetary restriction. At subsequent meetings policy resolutions moved toward greater ease. It had now been three months or more since the Committee undertook to achieve an easier policy, but it was not yet certain that it had been able to put such a policy into effect.

It was true that total bank credit had increased rapidly since November, Mr. Francis said. But bank credit had been a very unreliable measure of Federal Reserve policy during the past year. Bank credit increased rapidly, at a 10 per cent annual rate, last summer from May to August. It then declined in the fall, from August to November, at a 2 per cent rate. But that did not mean that monetary policy was tighter in the fall than in the summer.

The change reflected primarily the inability of commercial banks to hold large certificates of deposit after August when the rates they could pay were below open market rates.

Similarly, Mr. Francis observed, the shift of bank credit from declining in the fall to rising in the winter was not, in and of itself, a measure of easier monetary policy in the winter than in the fall. Rather, the shift in December reflected the fact that with lower open market interest rates the banks were again able to attract and hold large certificates of deposit. In view of that evidence, the rate of increase of bank credit recently had not been a useful indicator of monetary policy or of the direction of monetary influence. Interest rates had declined markedly since November, but that might reflect a decline in the demand for loan funds and expectations of lower rates rather than any real influence on the Committee's part.

When one deducted the increased reserves required for the reintermediation of the banks and for Treasury deposits, Mr. Francis said, one found that there had been no increase of bank reserves for net credit expansion from the second week of December to the present time. By that measure reserves were now a little higher than they were in last November, about the same as they were late last summer and early fall, and less than they were last April to June. The money supply did rise in the past month, but possibly the Committee should not give much weight to that upturn of the money stock if it could not see anything to support it in "reserves available for private demand deposits." He noted that the recent increase of money supply reflected in part a decrease in Treasury deposits and he noted that the staff expected no increase of money supply during March.

Mr. Francis believed the Committee should make a concerted effort to get the effective bank reserves measure moving ahead somewhat more than was necessary to accommodate the bank reintermediation. That would be something the Committee had not succeeded in doing in the past two-and-one-half months. To that end, it seemed to him the Committee had to let some of the current reduction of reserve requirements have some real stimulative effect. The Committee's net dealings in Government securities should be such that net reserves might be as much as $300 million, the top figure mentioned by the staff. A bill rate substantially below the discount rate should be looked on with favor--possibly one as low as 4.15 per cent, the bottom interest rate mentioned by the staff. So far as total bank credit was concerned, that was so much a function of the varying intermediation role of the banks that the Committee should let it go where it would, keeping its eye on total reserves, net of those required for time deposits and for Treasury deposits.

Mr. Francis favored alternative B of the staff's draft directives with the change that had been suggested in the first paragraph.

Mr. Patterson reported that in the Sixth District the effects of the turn toward an easier monetary policy showed up more in evidence that the availability of funds was improving than that the pace of economic activity was quickening. District member banks were now in a substantial free reserve position and had sharply reduced their reliance on the discount window and borrowing from the Federal funds markets. Their deposits, because of growth in time deposits, had been rising on a seasonally adjusted basis, and that growth had occurred in practically all sub-areas of the District. However, the banks were apparently concentrating on rebuilding their liquidity rather than on building up their loans.

The major exception was in construction lending, which picked up sharply in February at the large banks, Mr. Patterson said. Funds were becoming more available to mortgage bankers and other mortgage originators, and the net savings flow into savings and loan associations had improved markedly. An eventual stimulus to public works construction might result from the successful marketing of several municipal issues that had previously been postponed. What the latest data for the District seemed to indicate was that there was a strong chance that the weaknesses would eventually be overcome if there was no sudden cut-off in the availability of funds.

On the national scene, Mr. Patterson continued, interpreting the economic and financial indicators was extremely difficult, as the Committee knew; and, because of special circumstances, the Desk had had a very difficult job. Despite all the complications, however, the final result was an increase in bank credit, something that the Committee had wanted. The bank credit growth that occurred seemed especially appropriate in the light of the further weakening in private demand discussed in the current issue of the green book.

The lowered projections of GNP discussed in the current green book certainly implied that conscious or unconscious tightening of policy was inappropriate, Mr. Patterson said. A "wait-and-see" policy, he was afraid, might lead to the kind of unconscious tightening the Committee wanted to avoid. Steps toward further ease seemed to be in order now. How great those steps should be and the way they should be measured were perplexing problems. Treasury financing might preclude action for a short time. However, by the next meeting of the Committee he would like to see that open market operations, together with the reduction in reserve requirements, had supported a bank credit growth in March higher than the 6 to 8 per cent projected in the blue book, and on the order of the average annual rate that had occurred since last November. He would hope also that there would be no upward movement in the structure of rates. Under those conditions, he favored alternative B for the directive.

Mr. Hilkert remarked he was in the same boat with many observers of the economic scene who found the current and prospective situation especially difficult to evaluate. That was less true of the Third District economy than of the national economy. Following a year of strong pressure on economic resources, there were increasing signs of slack in the economy of the Third District. Demand for labor had eased, resulting in a greater-than-seasonal increase in unemployment in the majority of the labor market areas. Manufacturing output and employment had dropped from fall peaks, and final demand showed little signs of new strength. Construction contracts awarded, auto registrations, and the net change in consumer credit outstanding were considerably below comparable periods of the previous year.

In studies the Philadelphia Reserve Bank had made of the behavior of the local economy over the 1950's, Mr. Hilkert said, there was some indication of a lag behind the national economy at cyclical peaks. With all the attention being given currently to leading and coincident indicators, recent behavior of that lagging indicator suggested the rather frightening conclusion that the economy had been in a recession for some time. Although statistics on the national economy did not bear that out, they were not encouraging. The Bank's informal survey a month ago indicated that manufacturers were not cutting back the rate of inventory accumulation substantially because they expected rising sales to take care of excessive stocks. Data for January indicated that manufacturers, in fact, added to inventories at a faster rate than in the fourth quarter. There was now increasing doubt whether the expectation of rising sales would materialize. The results of the survey now appeared in a different light, therefore, and suggested that the longer the adjustment was postponed, the more serious it would become.

On the other hand, Mr. Hilkert continued, information about a second key uncertainty--housing--led him to a position of mild optimism. Lenders in the Third District believed that the supply of money for mortgages would increase somewhat within the next ninety days. Commitments had been worked off, so most institutions were in a relatively strong position to expand mortgages if demand picked up and if the trend of current savings flows continued. But although lenders' attitudes had improved in the past few weeks, a watch-and-wait attitude still prevailed.

Because information on demand was not best gathered from lenders, Mr. Hilkert said, the Bank had extended its inquiries to realtors and builders. Here the response had been more encouraging.

A number of realtors had indicated that demand was stronger than usual for this time of year. New listings were still low, however, possibly because potential sellers were discouraged by costs to them and recent terms of sale. Realtors believed more listings would come quickly once sellers learned about the demand.

Of course, Mr. Hilkert added, the sample was small and it was still very early in the season. But the results suggested that pressures of demand might become strong enough to overcome lenders' caution. Given an ample supply of savings--and the selective nature of the reduction in reserve requirements should help in that respect--the outlook for housing was brighter.

Mr. Hilkert thought the heavy flow of new issues in the corporate and municipal markets--despite the problems it had caused in the past few weeks--was also a favorable sign, even though watered by the greatly reduced volume of private placements. To the extent such financing needs could be accommodated easily, the possibilities that an inventory adjustment would have serious repercussions on capital spending might be reduced. Again, the reduction in reserve requirements should help in easing congestion in those markets.

In Mr. Hilkert's judgment, open market policy for the next four weeks should reinforce and sustain the effects of the reduction in reserve requirements. Expectations had been altered substantially and open market policy should confirm those changes in expectations.

If that should require fairly liberal net free reserves, he would have no objection. If it should mean permitting another strong increase in bank credit, that would be all to the good. And if, as he would hope, market rates continued to decline, it might later be necessary to make a technical adjustment in the discount rate.

Mr. Hilkert favored alternative B of the draft directives.

Mr. Hickman recalled that at the Committee's last meeting he had voted for a policy of "no change," shaded toward ease, partly because of the imminence of Treasury financing and partly to give the economy time to catch up with financial developments. He agreed fully with the directive as adopted, and with the intent to resolve doubts on the side of ease.

Having said that, Mr. Hickman continued, he had to say that market developments following the meeting departed sharply from what he thought was the Committee's intent, although in the last few days the market had again moved in the intended direction. In fact, the reaction to the reduction in reserve requirements demonstrated that the market was waiting for a signal from the System, which up to that point it had failed to provide. The tighter money market that developed throughout most of February upset the capital market, and largely reversed the easier tone that the Committee had sought to foster in preceding months.

There was a growing awareness that the economy was in a precarious situation, Mr. Hickman said. As the green book noted, and as he had been attempting to convey to the Committee for several months, weaknesses and imbalances in the economy were pervasive and deep-seated. Indeed, it was now an open question whether the economy was approaching--or had already past--the upper turning point in the business cycle. At the present juncture it was imperative that the Committee do all that it could promptly to prevent weakening tendencies in the economy from cumulating into a general downward spiral. Heavy inventories, coupled with the unfavorable outlook for consumer takings and business spending, increased the likelihood of sizable inventory adjustments in the near term. Thus far, inventory adjustments had been minimal--but the portents were ominous.

Mr. Hickman went on to say that it was thus clear, to him at least, that the Committee had to try to make up for lost time, and do more than it had done to stimulate final demand. Because of distributed lags in the effects of monetary policy on output and employment, the Committee knew only too well that the economy could not be turned on a dime. If it hoped to achieve anything like the second-half gains in economic activity envisaged by the Council of Economic Advisers, additional monetary stimulus should have been provided in February, and had to be provided now. If the Committee failed to head off weaknesses in the economy, it would be faced with a massive, and perhaps unmanageable, task later on.

Thus, Mr. Hickman supported alternative B of the staff's draft directives with the first paragraph modified as proposed by Mr. Brill. That alternative clearly called for greater ease. As for the targets, he would move fairly promptly towards free reserves of between $200 and $300 million, as suggested in the blue book, which presumably would keep the bill rate and Federal funds rate at or below the discount rate most of the time. He would also attempt to nudge long-term bond yields downward, in an effort to enlarge the flow of funds to the mortgage market, although that would be difficult because of the large calendar. If the System had any influence in the area of fiscal policy--which he doubted--he thought it should press for prompt reinstatement of both the investment tax credit and accelerated depreciation, and should encourage an early announcement that the proposed surtax on corporate and personal incomes would be dropped until such time as the economy appeared to be overheating.

Mr. Brimmer commented that he would like to endorse much of what Mr. Hickman had said. He had followed open market operations in the past month on almost a day-to-day basis and, while he certainly would want to commend the Manager's vigorous efforts to cope with market pressures, he thought that the outcome for much of the period was opposite to that which the Committee had intended to encourage. At the previous meeting he had joined the majority in voting favorably on the directive after the staff's original draft was modified to indicate an intention of leaning toward ease, and he had hoped that market conditions would become somewhat easier. Now, with the unfortunate outcome, he thought the Committee had to make up the ground that had been lost.

Mr. Brimmer agreed completely with Mr. Hersey's remarks on the balance of payments. The payments problem was serious and, if anything, it was likely to get worse. The question facing the Committee was how to mesh appropriately its international and domestic objectives, and he saw nothing in the short run that would suggest a course of action with respect to the balance of payments other than that Mr. Hersey had suggested. It appeared that the voluntary foreign credit restraint program had been making a useful contribution and would continue to do so. There seemed to be little prospect for a rapid revival of direct investment outflows. The current reflow of bank credit to foreigners was not indicative of what could be expected over the course of the year, and he would not be averse to the System's looking at its program in that area to see what might be done to dampen a later outflow of bank credit if that should prove necessary. The outlook for Congressional approval of the proposed extension and strengthening of the interest equalization tax appeared promising, and he thought that such a strengthening could be counted on for help. He certainly would not like to see the Committee try to head off the reflow of funds from American banks to the Euro-dollar market. That reflow had been expected, and it would be undesirable to hamper domestic policy by an effort to head it off.

With respect to the domestic situation, Mr. Brimmer continued, the only question in his mind was when, in retrospect, the National Bureau of Economic Research would date the downturn. They might decide that the turning point occurred late in the first quarter or early in the second. He agreed completely with Mr. Brill that it was time for the Committee to take note of recessionary tendencies, and he would endorse Mr. Brill's proposed language for the first paragraph of the directive. He saw nothing to indicate remaining autonomous strength in the private sector. Plant and equipment spending might, in fact, be lower than Mr. Partee had suggested; at this stage of the cycle successive revisions of capital spending estimates were likely to be downward, not upward as during an expansion. The earlier private surveys suggesting increases in fixed investment in 1967 on the order of 6 or 8 per cent should be discounted. He agreed with the staff's expectations for consumer spending, and he did not think the Committee should count on growth in defense spending to compensate for the weakening in the private sector. Personally, he foresaw a plant utilization rate in the low 80's, and an unemployment rate possibly as high as 4.5 per cent. In sum, he felt that expansion was not simply weakening, but that the economy was probably on the verge of a recession if not already in one.

As to the discount rate, Mr. Brimmer favored encouraging the Federal Reserve Banks to consider possible action. He agreed with Mr. Brill that the discount rate should be reduced soon and that the problem was primarily one of timing. He favored alternative B of the staff drafts for the directive, with Mr. Brill's suggested change in the first paragraph.

Mr. Maisel commented that he fully agreed that the economy was at a point of weakness. It was clear that the almost flat trend in real GNP projected for the first half of the year would mean a decrease in industrial production and an increase in unemployment. If such developments occurred they were almost certain to result in lower spending and production than the Council had projected for the second half of the year, and a further increase in unemployment. That meant that monetary policy should be more aggressive, particularly to permit long-term interest rates, including mortgage rates, to fall toward their levels in previous years.

Mr. Maisel said that he would not engage in additional post-mortems on market developments since the preceding meeting. The main lesson was that the kind of market move that had developed three weeks ago should not recur in the coming period; market expectations of easing had to be confirmed.

Mr. Maisel thought that reserves should be furnished aggressively. Given the country-wide distribution of the effects of the reduction in reserve requirements, he would assume there was a need for large net free reserves--in the $200-$300 million range. He favored a Federal funds rate fluctuating below the discount rate, and continued declines in the bill rate. He agreed with Mr. Brill that the rate of expansion of bank credit projected under those conditions was not unduly high; in fact, the growth in required reserves projected for the next six weeks was a good deal lower than experienced earlier. He would like to see bank credit continue to rise at a rate at or above the average rate since last November, and he assumed that that might be possible as a result of the increase in free reserves that he favored.

Mr. Maisel concluded by saying he thought that a discount rate change should be considered. However, he would hope that a reduction would be delayed until the bill rate had moved lower, so that the action would confirm rather than lead market developments.

That condition might well be fulfilled by the time of the Committee's next meeting. He supported alternative B of the draft directives.

Mr. Daane said he hoped the Committee would not undertake to tilt against windmills. He thought that monetary policy at this juncture could not stem a wage-cost push reflecting the inadequacies of fiscal and incomes policies of the previous period. Secondly, he thought the Committee could not stem an inventory adjustment that reflected the backwash from the earlier overheating of the economy. Whatever one might wish, he did not think that was feasible--certainly not in a short period. Third, he thought that at this juncture the Committee should not try to tilt quixotically against a sick balance of payments; monetary policy alone could not effect a cure.

However, Mr. Daane continued, he agreed with Mr. Brill that the Committee certainly should do all that it could do, and had to do, with the instruments at its disposal at this juncture. The main problem, as he saw it, was to sort out the psychological and expectational aspects of both the economic and financial environments. It was particularly necessary to aid in restoring confidence in economic prospects.

Mr. Daane said that, like others, he had been disturbed by the fact that market developments in the recent period had led observers to conclude that monetary policy had stopped trending toward ease. It was important that the market should not again have any doubt about the posture of System policy; it should be made perfectly clear, as it had been in recent days, that the System's posture was one of continuing ease. As Mr. Brill had noted, however, the key question concerned the rate at which the Committee should move toward ease. He (Mr. Daane) thought the Committee also had to guard against the risk of deluding the market and generating expectations that outran the Committee's intentions, as had occurred earlier in the year.

On that basis, Mr. Daane said, he would go along with much of Mr. Brill's analysis. He was disturbed, however, by the latter's suggestion that the phrase "to combat recessionary tendencies" be included in the first paragraph of the directive, because it suggested that monetary policy alone could stop an inventory recession in its tracks. He would prefer instead to say that it was the Committee's policy "to foster such money and credit conditions, including bank credit growth, as may contribute to a continuation of economic expansion and help to prevent any weakening tendencies in the economy from cumulating." That objective was one the Committee could accomplish; he did not think it should imply in its directive that it could do something it could not.

Mr. Daane leaned toward alternative B for the second paragraph. However, he suggested a revised formulation reading, "To implement this policy against the background of the current reductions in reserve requirements, System open market operations until the next meeting of the Committee shall be conducted with a view to continuing to ease moderately, but operations shall be modified as necessary to further moderate any apparently significant deviations of bank credit from current expectations." He thought that language carried the appropriate sense of continuing to move toward ease but of not generating expectations going beyond what was intended. He would not change the discount rate at this juncture.

Mr. Mitchell observed that seldom had previous speakers at Committee meetings said so little with which he disagreed as they had today. Accordingly, he had little to add. He endorsed the staff's analysis and most of the comments that had been made about it. In his judgment the main objective of monetary policy now should be to change bank lending policies as quickly as possible. The System had already accomplished a good deal in that connection, in that banks' liquidity desires had been largely met. But their lending policies had not yet changed to any significant extent; and until those policies were changed drastically the contribution of monetary policy would be very limited.

Mr. Mitchell agreed with Mr. Hickman that the Committee had to act quickly. Developments in the next month or two were already water over the dam, but the Committee could have some effect on events of the summer and fall if it did not back and fill now. He favored a much more aggressive policy, limited only as necessary to avoid the psychological impact that would result from an impression that the Federal Reserve was deeply worried about the economic outlook. He would not want to move so aggressively as to create that impression.

With respect to operating targets, Mr. Mitchell agreed with Mr. Francis that the Committee should get the money supply growing, and on some basis other than shifts out of Treasury balances; the money supply should grow because reserves were being aggressively supplied. In that connection he noted that the credit proxy chart in the blue book seemed to indicate the absence of any significant growth in February. As far as bill rates and free reserves were concerned, he would let them go to whatever levels were needed to accomplish the desired expansion of the aggregates. He thought a fairly low bill rate would be required--perhaps around 4 per cent--but he would go along with a 3-1/2 per cent rate if necessary or, for that matter, with a 4-1/2 per cent rate; the bill rate should be treated strictly as a residual.

As to the directive, Mr. Mitchell said, he thought Mr. Daane's objections to Mr. Brill's proposed phrase for the first paragraph could be met by saying it was the Committee's policy to combat "the effects of" recessionary tendencies. He favored alternative B for the second paragraph, but would delete the word "somewhat" before "easier conditions in the money market." In his judgment easier conditions were definitely needed and the qualification was undesirable.

Mr. Shepardson said that, like Mr. Mitchell, he agreed essentially with the analyses that had been presented thus far. He agreed particularly with the inference he drew from Mr. Hersey's remarks that a balanced approach was necessary to the problems facing the Committee.

In the present situation, Mr. Shepardson continued, it seemed to him that there were grounds for moving toward an easier monetary situation. He had been disturbed for a considerable time over what seemed to be a reluctance to act vigorously against excessive rates of economic expansion. The Committee had tended to move too little and too late, so that it had found itself faced with the kind of severe adjustment that had occurred last summer. Two wrongs did not make a right, and he did not favor moving too slowly when ease was required simply because earlier moves toward firmness had been too slow. In sum, he agreed that there should be some further easing at this time. He would hope, however, that the Committee would arrive at a point where it would be just as aggressive in restraining economic excesses as some members thought it should be in acting against adjustments in the other direction that in many cases seemed to him to be healthy.

Mr. Shepardson liked Mr. Daane's suggestion for the first paragraph of the directive. He agreed with Mr. Hayes that about the same results could be accomplished with either alternative A or B for the second paragraph if the language of B was modified somewhat. He would not be opposed to alternative B if it were tempered as Mr. Daane had suggested.

Mr. Wayne said that to conserve time he would omit all reference to District business conditions. In general, he agreed with the analysis of national developments given in the green book. The staff comments this morning were indeed sobering.

On the policy for the period ahead, Mr. Wayne favored a distinct but gradual easing of credit conditions. The major problem was to achieve an orderly and gradual movement. In the turbulent conditions of the past two months, largely because of volatile expectational factors the market had swung too far, first in one direction and then in the other. No monetary policy could be effective in such conditions, which necessarily left both borrowers and lenders uncertain and confused.

Mr. Wayne noted that he had participated in the daily telephone conference call during the past month, and had been impressed by the unreliability of the projections, by the wide fluctuations that had occurred in market conditions, and by the difficulties that the Desk had faced from day to day in trying to carry out the terms of the directive without at the same time engendering further volatile expectations in the market. He had never seen a more difficult period for open market operations, and he thought that the Desk had performed quite well.

As Mr. Holmes had noted, Mr. Wayne continued, the Treasury had authorized the Desk to inform the market fully about the character of the massive operations that were carried out in the recent period for the trust accounts. He would suggest that the Committee might give careful thought to the fact that the Desk's explanations had a highly desirable effect on the market's ability to absorb the operations without undesirable repercussions. He was not suggesting that explanations of what was being done should be made to the market each day. He was merely noting an experience in which large operations, which could have led to undesirably sharp movements in the market, had in fact been handled smoothly by fully informing the market; and suggesting that the Committee might give some thought to following such a policy if similar conditions arose in the future.

In resisting the rapid upsurge of rates in February, Mr. Wayne observed, the Desk had found it necessary to supply larger amounts of reserves than might have been anticipated. The banks apparently used all of those additional amounts to increase their investments, partly in an effort to rebuild their liquidity. In addition, borrowing had reached a very low level and banks would not feel the full effect of the reduction in reserve requirements until next week. The Treasury balance also had been reduced to a nominal amount and the Treasury might borrow from the Federal Reserve within the week. All of those developments provided fuel for a further easing of rates, which was desirable. If possible the Committee should avoid the development of expectational factors which might trigger a stampede in either direction.

To summarize, Mr. Wayne said, he favored a definite move toward ease but with safeguards to prevent it from getting out of hand. To accomplish that, it seemed to him that the Desk should place primary emphasis on interest rates and be prepared to see wide fluctuations in free reserves. The goal should be to hold the bill rate and the Federal funds rate moderately below the discount rate with the expectation that that would exert downward pressure on longer rates. In the process, he would hope that the growth of the bank credit proxy would be above the 6 to 8 per cent figure mentioned in the blue book but somewhat below the rates of January and February.

Mr. Wayne agreed with Mr. Mitchell that a change in the direction of ease in the credit practices of the commercial banks was badly needed. Some further reduction in the prime rate might be necessary as an overt move to achieve that result. If the easier policy contemplated by alternative B for the second paragraph of the directive as modified by Mr. Daane--which he favored--did not lead to downward adjustments at commercial banks during this month, a reduction of 1/4 per cent in the discount rate would be appropriate. As of now, he would hope that no change in the discount rate would be required in the next four weeks.

Mr. Clay commented that recent evidence concerning the performance of the national economy had not been particularly encouraging. Unseasonably severe weather in important marketing and production areas undoubtedly had taken its toll. Nevertheless, recent news on the economy's performance had raised considerable question about the strength of the economy in the months ahead. Certainly the prospects were less encouraging than they had appeared a month ago.

The economy continued with many cross-currents, Mr. Clay observed, and generalizations for the total economy were by no means unambiguous. One of the seeming contradictions was the continuing strength in employment and the marked shortage of qualified labor despite the slow progress of economic expansion. Adjustments in labor inputs had been made, however, by reducing the length of the workweek. Moreover, total employment tends to lag other activity measures, especially when uncertainty about the future suggests to business firms the advisability of holding together a qualified labor force.

In view of the current state of the economy, further monetary action to encourage economic expansion appeared to Mr. Clay to be in order. That judgment was underscored by the probability of further deterioration in business prospects. The recent turnaround in short-term interest rates to lower levels had been encouraging, but action to further ease interest rates, particularly long-term rates, was called for. While the large volume of financing was an important factor stiffening long-term interest rates, monetary policy action could be a moderating force in those financial markets.

Such a policy, Mr. Clay said, would embrace further easing of money markets and thus a move toward lower levels of interest rates. It presumably would also involve a larger rate of increase in bank credit in March than that projected by the staff on the basis of current monetary policy. Obviously, the implementation of policy should take into account the availability of reserve funds resulting from the reductions in reserve requirements on time and savings deposits.

Alternative B of the draft economic policy directives was satisfactory to Mr. Clay for the period ahead, essentially in line with the relevant discussion in the blue book.

Mr. Scanlon reported that February brought additional evidence in the Seventh District that demand pressures on available manpower, materials, and facilities were easing. Development of pessimistic attitudes on the part of businessmen and consumers was spreading. With retail sales about level, total business inventories relatively high and rising rapidly, large user holdings of recently purchased long-lasting goods, and continued upward pressure on costs, he agreed with those who felt the economy could be entering a period of substantial adjustment in both the rate of growth and the mix of private demand.

At present, Mr. Scanlon said, the only manufacturing activities in the Seventh District that showed good prospects of continued expansion were farm machinery, electrical generating and transmission equipment, defense equipment, and color television. In the latter case a shift of product mix, placing greater emphasis on the lower-priced sets, was in process. Recent sharp declines in orders for such capital equipment as machine tools, presses, and railroad equipment reflected, in part, the growing view that the investment tax credit would be restored before the end of the year, perhaps before midyear.

Adverse weather conditions, of course, had had a particularly severe impact on construction activity, Mr. Scanlon noted. Permits for apartments in the Chicago area in January were the lowest for any January since 1959 and permits for homes were the lowest since January 1945. But experts in the area believed the home building picture was certain to improve rapidly. Mortgage credit terms were easing and rates on new loans were down as much as 50 basis points from last year's highs. Reports of layoffs in various hard and soft goods lines continued, but large increases from last year in new claims for unemployment compensation had been confined largely to the automotive centers. Help-wanted advertising had declined in recent months after a long increase, but remained at a relatively high volume. Reserve positions of major Chicago banks had become more comfortable in the past month and none of them was currently borrowing at the discount window.

In light of the further weakening of the over-all economic outlook, it appeared wise to Mr. Scanlon to continue to provide reserves at a rapid rate to accommodate any current desires of financial institutions and other businesses to rebuild liquidity. He believed the current discount rate was appropriate for the current period, but agreed with those who thought the System should consider a move shortly. He favored alternative B of the draft directives, as amended by Mr. Daane.

Mr. Strothman said that he needed to spend little time in commenting on economic developments in the Ninth District, for the pattern had been essentially similar to that of the nation as a whole. Modest differences might be noted in some components, but since those were truly modest and were to some extent evidenced by fragmentary data, he was left on balance with the conclusion that what was good for the United States was good for the Ninth District, and vice versa.

The economic outlook of recent weeks, and now, seemed to the Minneapolis Reserve Bank to call for modestly greater monetary ease, Mr. Strothman continued. Consequently, he had welcomed the change in reserve requirements and would hope to see it confirmed to market participants as an overt move toward greater ease. He was apprehensive lest the reserve requirement change be dismissed as simply a device for supplying seasonal reserve needs. The maintenance of consistently positive free reserves would seem to be necessary.

However, Mr. Strothman said, he would hasten to add that his inclination was to focus somewhat more sharply on market interest rates than on free reserves. He would wish to see a continuing modest easing of money market rates. Although at present some emphasis might be placed on the word "modest," he rather expected that, as the near-term future unfolded, short-term rates generally would find levels significantly below 4-1/2 per cent, and that in the not too far-term future, a discount rate change might be called for. That, of course, was only a suggestion of the need for serious thought to the possibility of a discount rate change. In offering it he was perhaps swayed by some skepticism that further significant reduction in the world level of interest rates could be achieved without a signal from the United States.

Mr. Strothman favored alternative B of the draft directives.

Mr. Swan said he would make two brief observations about economic conditions in the Twelfth District. First, the strength in the aggregate employment figures was somewhat paradoxical in light of certain other aspects of the District economy. The contrast was particularly marked in January when a rise in employment, seasonally adjusted, brought the sharpest drop in the unemployment rate in some time--from 5 to 4-1/2 per cent. The January figure was the lowest in eight months. On the other hand, seasonally adjusted private housing starts, which rose 18 per cent in the rest of the country in January, dropped below the low levels of November and December in the Twelfth District. If housing starts were rounding the corner nationally, the Twelfth District was somewhat behind.

Mr. Swan went on to say that he would certainly favor some further easing in view of the prospects for the economy that had been discussed this morning and in view of the situation that developed in financial markets in the last month. The reduction in reserve requirements had been particularly timely in terms of its influence on market expectations. As had been mentioned, one of the Committee's aims in the period ahead should be to confirm market expectations that that action was not intended simply as an alternative to open market operations as a means of supplying reserves, but rather to add significantly more reserves. At the same time, like Mr. Mitchell he would want to stop short of the point at which observers would believe that the System was overly concerned about the outlook. In any case, he favored free reserves of $200-$250 million and somewhat lower bill rates and Federal funds rates through the next four weeks. He hoped that a discount rate decrease would not be found necessary during that period. While a discount rate change might have a direct effect on bank lending attitudes, a preliminary review of the results of the recent lending practices survey in the Twelfth District indicated that some change had already occurred in such attitudes.

Obviously, Mr. Swan said, he favored alternative B for the second paragraph of the directive. For the last sentence of the first paragraph, he could accept either Mr. Daane's proposed language or Mr. Hayes' suggestion that the term "weakening tendencies" be substituted for the term "recessionary tendencies" in the phrase Mr. Brill had proposed.

Mr. Irons observed that economic conditions in the Eleventh District were following the national pattern closely. There had been weakening in various sectors of the District economy, including retail trade, construction, and industrial production. Rising defense expenditures, however, were offsetting the weakness in private spending to some degree. The agricultural situation was not as satisfactory as it had been earlier, partly because of weather conditions and partly because of price developments.

District banks were more liquid than some months ago, Mr. Irons said. However, he thought more time would be required for the banks to reach a position that they would regard as adequate; they continued to recall with concern the extremely illiquid position in which they had found themselves last summer. Their concern with liquidity might be one factor explaining the composition of the recent rise in bank credit. Certainly the larger banks in the Eleventh District were relying much less on borrowings, both in the Federal funds market and from the Reserve

Bank. The volume of discounts at the Dallas Bank had been negligible recently, with no large banks coming to the window. Only a few small country banks with seasonal needs were borrowing. District banks also were less ready buyers of Federal funds; while they remained net purchasers, the volume was small. Loan demand had been strong recently, but it was not frantic, as had been the case earlier.

Mr. Irons said he had found the staff's forthright analysis of the national economy to be quite helpful. As to policy, the reduction in reserve requirements had been interpreted by bankers and others in the Eleventh District as a clear indication of an overt move toward greater ease. For a while prior to that action there had been some feeling of uncertainty as to whether the easing that occurred earlier was being continued, or whether a firmer policy was creeping back. That uncertainty was dispelled by the Board's move. He thought the System now should avoid confusing the market; its open market operations should not be inconsistent with that overt signal of ease.

Accordingly, Mr. Irons favored alternative B for the directive. He thought emphasis in the coming period should be more on interest rates than on the level of free reserves, and he would prefer to see the credit proxy rise faster than projected in the blue book. In his judgment, a Federal funds rate in the neighborhood of 4-1/4 to 4-1/2 per cent, a bill rate of about 4.25 to 4.30 per cent, and free reserves possibly ranging around $200 million would not be an inappropriate alignment. He would not favor immediate action on the discount rate but, depending on conditions, the System might well be giving thought to such a step by the time of the next meeting. Like a previous speaker, he would prefer to act on the discount rate at a time when market rates had fallen further rather than to take an anticipatory action.

Mr. Ellis complimented Messrs. Partee, Brill and Hersey on their persuasiveness but added that, as would become obvious from his remarks, he had not fully acquired the sense of gloom that wove through the green book and their discussion. He suspected that resulted partially from looking at a region which did not depend heavily on automobile production and had not been hard hit by heavy storms this winter, and did feel the impact of continuing heavy defense ordering.

For example, Mr. Ellis continued, a recent article in the press contained a dire prediction of downturn in the textile industry. The Boston Reserve Bank's survey of the New England portion of that industry suggested that their capital outlays would hold close to 1966 levels, which were 14 per cent above 1965 outlays. Reporting firms expected their 1967 sales to hold at 1966 levels. Manhours in the region's textile industry rose (seasonally adjusted) in January and the production index held at the December level. In the past three weeks seven regional firms received over $7 million in defense orders and the Defense Department had announced intentions to buy 10.6 million yards of wool cloth this year. He concluded that the forecast for the regional textile industry was not bleak for 1967.

On a more general level, Mr. Ellis said, the Reserve Bank's capital expenditures survey of New England manufacturers tended to support the recent McGraw-Hill estimate. With the sample presently not completed, he anticipated the forecast for 1967 would fall in the plus 6 to 10 per cent area. Only one firm in ten looked for sales to drop this year, and the expected increases averaged out to 10 per cent.

By virtue of $60 million of dividend credits, deposit balances at the District's 80 mutual savings banks increased by $52 million in January, Mr. Ellis noted. Last year the gain was only $24 million. Their real estate loans increased only $8 million in January, compared with $35 million last year. They were still seeking to rebuild their cash positions before resuming aggressive lending. The Reserve Bank's monthly survey of the cash flow and commitments activities of the insurance companies revealed about the same type of improvement. The January increase in policy loans was below the average increase for the closing months of 1966 but higher than the normal monthly increases of past years. Total mortgages were staying unchanged but new commitments on securities had turned up materially--from a very low 1966 level.

In evaluating economic trends to be affected by monetary policy, Mr. Ellis emerged with a conviction that the underlying position was still one of continued strength camouflaged by an inventory "situation" and further confused by an automobile "situation." If the full impact of slowed sales and production of autos could be successfully identified and subtracted, he thought one would find the remaining components of the industrial production index would still be expanding.

Of course, Mr. Ellis said, there was little point to such an exercise unless there was some reason for anticipating that the present fact of slowed auto sales and general retail sales might be reversed. Here he came to a point on which Mr. Mitchell had already commented. The green book said that "the estimated levels of personal and disposable income have been revised upward appreciably for the first quarter." But, pressing further, the green book emphasized that the first quarter increase in disposable income of $10.5 billion would be associated with a rise of only about $3.5 billion in consumer spending, with a consequent rise in the savings rate to 7 per cent where it was projected to hold through the first half. He still found such a projection difficult to accept. It would seem to him more logical to anticipate that the savings rate would return to more traditional levels, that consumers would spend a more traditional portion of a sharply rising income, and that consumer spending would be counted along with rising Government outlays as a strong and rising demand component of GNP. Accordingly, he ended up anticipating that the first and second quarter GNP gains would exceed the $5 billion now projected by the staff.

Mr. Ellis felt that a monetary policy in harmony with that type of economic projection, and recognizing the built-in aspects of cost-push inflation now at work, would seek to provide reserves liberally--but would avoid such rapid credit expansion as to add demand-pull price pressures to those already at work. Viewed in retrospect, the Committee might properly credit monetary policy since November with such a stance. Bank credit had been expanding at a 10.7 per cent annual rate and money supply, narrowly defined, had increased at a 6.2 per cent rate. He had no apologies for the rate of nonborrowed reserve creation of 21 per cent in February. As to Mr. Mitchell's observation regarding the movement of the bank credit proxy in February, he noted that a table in the blue book showed a rise of $3 billion in that month. Perhaps there was an error in the chart to which Mr. Mitchell had referred.

Looking ahead, Mr. Ellis continued, the Committee might anticipate some further stimulation from the recent cut in reserve requirements and the easier posture indicated to the market by a switch last month to a record of net positive free reserves averaging $48 million. There was ample evidence that banks were prepared to utilize the reserves the Committee made available. It would be surprising indeed if the current projections for a 6 - 8 per cent gain for March in the bank credit proxy were not substantially exceeded, at least to match the cumulative rate of 10.7 per cent that had been achieved since November 16, 1966.

The competition for funds in the market for the next few months was likely to become intense, Mr. Ellis said. The record corporate calendar faced the prospect of competing with Government sales of participation certificates. In that atmosphere an attempt to bolster housing by pushing substantial funds into the mortgage market via commercial banks might well result in leading the Committee to push reserve creation beyond safe limits. Construction employment in the latest data was within 4 per cent of the all-time peak reached in March of last year. It was difficult to conceive that the housing industry could be restored to its earlier peak levels without developing severe strain on real resources. In that situation, it would seem wise to avoid casting monetary policy principally with such an objective in mind.

All of that led Mr. Ellis to the conclusion that the Committee need not make substantial further moves of policy at this time. The reserve requirement reduction had spoken for the System for now, and expectations should not be overly stimulated. Either alternative A of the draft directives, or alternative B as modified by Mr. Hayes, would seem appropriate for the next few weeks.

Mr. Robertson made the following statement:

> I can be quite brief this morning, for our choice, as I see it, is fairly clear. I believe we must direct open market policy toward further ease. As a practical matter, we need to do this in order to carry through the easing atmosphere created by our reserve requirement reduction. The credit climate that has developed in the wake of that action seems salutary to me, particularly after the unfortunate tightening episode of previous weeks. But to preserve and extend this better atmosphere requires that a significant part of the required reserves released be left with the banks to encourage more ample credit availability, rather than being mopped up promptly by offsetting open market operations. This is particularly true on this occasion, when a sizable part of the reserve cut accrues to banks that may be slow to put their excess reserves to work.
>
> Operationally, this means allowing free reserves to increase substantially during the weeks immediately ahead--and allowing them to increase enough to keep central money market conditions on a gradually easing trend all through the coming tax payment period.
>
> How the banking aggregates might behave in these circumstances is more than ordinarily conjectural, as already has been suggested in the comments here this morning. My own view is that we should be more sensitive to shortfalls in bank credit expansion during this period than to overshoots in excess of projections. This is fundamentally because I think the economy is in the process of a difficult transition from a period of

> excessive demand pressures to a period of sustainable growth. And I want bank credit to be amply available so that the transition can be accomplished with a minimum of loss in potential output--and preferably, of course, without any. I am basically bullish rather than bearish as to our ability to work out of this adjustment without having to endure a full-fledged recession, but I want to be sure that monetary conditions are a constructive influence rather than a drag on that adjustment.
>
> With these views in mind, I would be in favor of directive alternative B essentially as drafted by the staff, and I would have in mind about the kind of money market and reserve conditions associated with that alternative in the blue book. Given the attitude toward bank credit expansion to which I have already subscribed, I could vote for the one-way proviso clause contained in the staff draft but I would prefer the usual two-way proviso clause with the understanding that deviations on the upside would have to be a good deal larger to be interpreted as "significant" than would deviations on the downside.

Mr. Robertson added that he favored Mr. Brill's suggested change in the final sentence of the first paragraph. Unlike Mr. Daane, he thought that saying it was the Committee's policy to "combat" recessionary tendencies did not imply that the Committee thought it could control such tendencies. He would suggest a revision in the latter part of that sentence, however. Rather than indicating that it was the Committee's policy to foster conditions conducive to progress toward reasonable balance of payments equilibrium, he would prefer to conclude the sentence with the phrase, "while recognizing the need for progress toward reasonable equilibrium in the country's balance of payments."

Mr. Mitchell said he would like to clarify his earlier comment on changes in the bank credit proxy in February. The relatively level trend shown on the blue book chart related to the three weeks ending March 1. Growth in the preceding two weeks was stronger, and, as Mr. Ellis had noted, growth on average from January to February was $3 billion.

Mr. Holmes commented that the rapid growth in the proxy in the earlier part of February had occurred at a time when the Desk was combatting a tightening money market. The small subsequent growth was associated with easing money market conditions.

Chairman Martin remarked that the Committee seemed to be in agreement today on the desirability of moving toward easier money market conditions. He concurred in the comment by Mr. Mitchell and others that the Committee did not want to give the impression that it was extremely concerned about the economic outlook.

In general, the Chairman continued, he was quite pleased with the course of monetary policy since last November. In that period the Committee had been moving steadily and gradually toward easier monetary conditions without going overboard. Perhaps the Committee had not been completely successful in achieving its objectives over the past four weeks, but the situation had been corrected quite promptly. Looking back through the minutes of previous meetings, as he had done in preparing for today's meeting, it struck him that this was the first time since 1960 that the economy had experienced some semblance of the February doldrums. The fact that there were doldrums this February did not necessarily suggest that the economy was on the verge of a major collapse. Rather, it might be going through a healthy adjustment.

The Chairman agreed with Mr. Daane that monetary policy could not be expected to correct all of the difficulties that resulted from the fact that appropriate fiscal policies had not been pursued in the past. Nevertheless, the Committee had to do everything that it could.

Chairman Martin then noted that various suggestions had been made for revising the final sentence in the staff's draft of the first paragraph of the directive. He thought the Committee's intent was perfectly clear; the problem was to arrive at the best form of statement.

After discussion, it was agreed that the sentence in question should read, "In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions, including bank credit growth, conducive to combatting the effects of weakening tendencies in the economy, while recognizing the need for progress toward reasonable equilbirium in the country's balance of payments."

The Chairman then noted that most members had indicated a preference for a second paragraph along the lines of alternative B. Although some proposals had been made for revising the language, he would suggest adoption of alternative B as drafted by the staff.

Mr. Hayes asked whether there was any disposition to accept Mr. Robertson's proposal that a two-way proviso clause be used, with the understanding that there was more concern about possible downward deviations of bank credit from expectations than about upward deviations.

Mr. Daane noted that he also had expressed a preference for a two-way proviso, in addition to proposing other language changes.

Messrs. Mitchell and Maisel indicated that they preferred the one-way proviso of the staff's draft. Mr. Maisel added that a two-way proviso might interfere with the objective of achieving further interest rate declines.

Chairman Martin then proposed that the Committee adopt alternative B for the second paragraph, with the understanding that a special meeting of the Committee could be called if bank credit expansion appeared to be getting out of hand. He suggested that the Manager bear that possibility in mind.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following current economic policy directive:

The economic and financial developments reviewed at this meeting indicate some decline in industrial production and a marked slowing of expansion in overall economic activity. Lack of growth in retail sales may be retarding adjustment of inventory accumulation from its recent excessive rate. Average commodity prices have changed little recently, but unit labor costs in manufacturing have risen further. Bank credit expansion has been vigorous and, after a period of rising interest rates and congested bond markets, financial conditions have again turned easier. Recent data suggest little improvement in the foreign trade surplus but also little increase in the outflow of U.S. capital. In several important countries abroad, economic activity has been softening for several months and monetary and fiscal policies have eased somewhat. In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions, including bank credit growth, conducive to combatting the effects of weakening tendencies in the economy, while recognizing the need for progress toward reasonable equilibrium in the country's balance of payments.

To implement this policy against the background of the current reductions in reserve requirements, System open market operations until the next meeting of the Committee shall be conducted with a view to attaining somewhat easier conditions in the money market, and to attaining still easier conditions if bank credit appears to be expanding significantly less than currently anticipated.

Chairman Martin then noted that there had been distributed to the Committee a memorandum from Mr. Hackley dated February 20, 1967, and entitled, "Effect of 'Freedom of Information Act' on

Procedures of the Federal Open Market Committee."[1] The Chairman suggested that the Committee discuss the subject preliminarily today and plan on considering it further at its next meeting. He asked Mr. Hackley to open the discussion.

Mr. Hackley noted that at the meeting of the Committee held on November 22, 1966, he had summarized the provisions of the so-called "Freedom of Information Act" and had indicated in general terms how the Act might affect the operations of the Committee when it became effective on July 4, 1967. At that time he had noted that the Department of Justice was preparing a Manual for guidance of Government agencies in modifying their procedures to comply with the Act. The Board's Legal Division had received a draft of the Manual in January and had found it helpful, although not to the extent that had been hoped. After reviewing the draft and studying the law further, the Legal Division had offered to the Justice Department some suggestions for additions to the Manual that would help clarify the application of the Act to the procedures of the Committee and the Board.

Mr. Hackley suggested that the Committee follow the general principle of aiming for the minimum changes in its procedures necessary to comply with the spirit as well as the letter of the

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

law, without endangering functions. The draft Manual was helpful in suggesting at a number of points that the new law did not require any disclosures that would impair the effectiveness of an agency's statutory functions.

Today, Mr. Hackley continued, he would not attempt to review the more detailed provisions of the law as set forth in his memorandum. Instead, he would concentrate on two main points: the documents of the Committee that were required to be published in the Federal Register, and the other records that would have to be made available to members of the public on request.

With respect to the first point, Mr. Hackley said, the new law made no change in the <u>kinds</u> of documents required to be published in the Federal Register--i.e., substantive rules and regulations, rules of organization and procedure, interpretations, and statements of general policy. However, the scope of the requirement was drastically changed as a result of changes in <u>exemptions</u>. In the past, the Committee's Regulation, its Rules of Organization, its Rules Regarding Information, Submittals, and Requests, and its Rules of Procedure had been published in the Federal Register and they would continue to be published. Some minor revisions probably would be necessary in the Rules of Organization and Rules of Procedure, and the Rules Regarding Information would have to be recast. The new law, like the old, required publication in the Federal Register of "statements of general policy and interpretations of general applicability." Four documents would seem to fall in this category: the continuing authority directive with respect to domestic operations, the authorization for System foreign currency operations, the foreign currency directive, and the domestic current economic policy directive adopted at each meeting of the Committee. In the past these documents, and any amendments of them, had been set forth in the Board's Annual Report, as required by section 10 of the Federal Reserve Act. They had been exempt from publication in the Federal Register, however, under the provision of the 1946 Administrative Procedures Act that permitted non-publication on the ground that it was justified in the "public interest" or "for good cause found." Those exemptions would not be available under the new law; non-publication in the Federal Register would have to be based on one of nine grounds specified in the new law and listed in his memorandum.

There was no question in his mind, Mr. Hackley continued, that the authorizations and directives did reflect "statements of general policy." Even though they were literally issued for the guidance of the Federal Reserve Bank of New York, in his judgment they were among the most important statements of general policy adopted by any agency. The question was not whether those documents should be published--as he had noted, they were published now--but whether the new requirement that they be published "currently" permitted a time lag. The Justice Department's draft Manual indicated that the word "currently" should be given a reasonable construction, but to clarify the matter further the Board's Legal Division had suggested to the Justice Department that specific language be added to indicate that publication in the Federal Register could be deferred for a reasonable time in cases where immediate publication would impair an agency's functions. In its letter to the Justice Department the staff had suggested that a lag of 60 days might be appropriate--having in mind the current economic policy directive in particular--but it had selected that period rather arbitrarily. Perhaps a longer lag might be required--say, 90 days--either as a general rule or in particular circumstances in order not to defeat the purposes of an action with respect to the current policy directive. With respect to the continuing authority directive and the authorization and directive for foreign currency operations, it might be appropriate for the Committee to publish them as soon as possible after their adoption or amendment. While the question was, of course, for the Committee to decide, some of the staff economists seemed to feel that no harm would be done by immediate publication of those documents.

As to the second point--that certain other Committee records had to be made available to any person on request--Mr. Hackley noted that any person whose request was denied could bring a court action in which the burden of proof would be on the Committee to justify that denial under the terms of the law. Most of the Committee's records--including the green book, the blue book, and the written reports of the Manager and Special Manager--clearly would be exempt on the ground that they were inter-agency or intra-agency memoranda or letters that would not be available to a private party in litigation--one of the nine specific exemptions in the law. The most important remaining records were those that had traditionally been described as the Committee's minutes. To the extent that those documents constituted a record of discussion prior to action, he thought they could be considered as inter-agency memoranda and thus exempt; and he had suggested language for the Justice Department's Manual that would so indicate. However, insofar as the minutes consisted of records of action, they clearly were not exempt. Accordingly, he recommended that in the future the documents traditionally described as Committee "minutes" be divided into two documents: one, to be called "memorandum of discussion," would be identical with what was now called the "minutes"; the second, consisting simply of a statement of the actions taken at the meeting, would be called "action minutes." The latter document would be similar in form to the kind of "minutes" that he understood most multi-member agencies maintained. The action minutes would be made available upon request but, since they would include the current policy directive adopted, only after a reasonable time. It would appear appropriate to refuse access to the action minutes until such time as the directive was published in the Federal Register.

While those recommendations might best be described as preliminary, Mr. Hackley said, he thought they would comply with both the letter and the spirit of the law. He had not referred to the possibility of publishing the current policy directive and the reasons for its adoption--perhaps in the form of the present policy record entries--in the Federal Reserve Bulletin because such a procedure would go beyond the requirements of the law, but it was one that the Committee might wish to consider. He thought that the main question for the Committee to decide was what constituted a "reasonable" time lag for publishing particular documents or otherwise making them available; that is, how soon after their adoption they could be released without endangering the Committee's functions.

Mr. Robertson commented that Mr. Hackley presumably had selected 60 days as a reasonable time lag on the ground that in the past the Committee had made its policy record for the preceding year available to the public early in the new year, roughly 60 days after the December meeting. That point had merit. However, if it lay within the Committee's discretion to determine what time lag was reasonable, it might be desirable to select some longer period at the outset and shorten the period later if that was found feasible. Thus, it might be best to start with a lag of one quarter for all actions and then, perhaps, work down to 60 days.

Mr. Maisel thought it might be preferable to stay closer to the present procedure by publishing all of the actions taken during a quarter 60 days after the end of the quarter. In his judgment there would be a great advantage in having the directives become public in groups, four times a year, rather than singly.

Mr. Brimmer agreed in general with Mr. Maisel but thought that the Committee should keep certain other considerations in mind. First, as illustrated by the experience this year, there was something to be gained by releasing the policy record entries for the closing months of the year early enough in the new year for them to be available around the time the Economic Report and the Budget Message were being discussed. The schedule adopted should not preclude such timing. Secondly, he had been thinking in terms of publishing the complete policy record entries, rather than the directives alone. But the entries drew extensively on the economic analyses in the staff reports which, in turn, frequently rested on information that had not yet been publicly released. He hoped the staff would consider the question of how quickly the entries could be released without violating confidentiality. As he had noted, however, he agreed that there were advantages to publishing a well-reasoned spectrum of experience quarterly rather than separate entries for each meeting.

Mr. Hackley said he thought the crucial question concerned not what publication procedure would be most desirable in general but what procedure would comply with the requirements of the new law--which, he emphasized, required publication of general policy statements "currently." He was not sure that publication of the Committee's directives on a quarterly basis with a 60-day lag would be legally defensible. The Committee would have to justify refusal of any request for access to unpublished directives, and he was concerned with the possibility that it might not be possible to muster reasons satisfactory to a court in defense of such a schedule.

Mr. Robertson noted that quarterly publication with a 60-day lag would result in a five-month delay for the first actions of a quarter. Five months appeared to be a long time for the purpose.

Mr. Hickman suggested that it might be desirable to release the policy record entries individually, with an appropriate lag, and supplement them with quarterly reviews that would provide a longer perspective.

Mr. Maisel commented that further analysis of the question was obviously required. To his mind, however, releasing information on Committee actions serially was likely to be confusing. He thought it made more sense to release the information quarterly, and that a schedule such as he had suggested, if fixed and known, probably could be justified.

Mr. Daane thought that the question the Committee should answer first was whether, as Mr. Hackley had suggested, the Committee was required by the new law to publish its directives in the Federal Register. He thought the Committee should make its records more generally available, and he was quite sympathetic with Mr. Maisel's suggestion for quarterly publication of the policy records rather than annual publication as at present, keeping in mind the points Mr. Brimmer had made. But if the Committee was required to publish its policy statements "currently," he was not persuaded that it could justify a lag of 60 days. The fact that that had been the minimum lag in the past did not seem, in itself, to provide a very strong defense under the new law for 60 days as opposed to some other interval.

Mr. Hackley said that his view that the Act required publication of the directives in the Federal Register as statements of general policy was based on the fact that in the past the Committee clearly had regarded them as policy statements, and had included them in its Record of Policy Actions published in the Board's Annual Report under the terms of the Federal Reserve Act. It would be very hard to overthrow the argument that they were policy statements. He thought that a 60-day lag might be justifiable on the grounds that it had been the minimum lag in the past. Moreover, there might be times when a particular directive was so sensitive that it would be desirable to withhold it for more than 60 days. But the Committee might be on the defensive at the outset with regard to lags because of the language of the law specifying that policy statements be published "currently." As he had indicated, the Legal Division was attempting to have the Justice Department clarify the point in its Manual.

Mr. Daane asked whether the President had not indicated on signing the new law that there would be an element of flexibility in terms of making information available consistent with the national interest.

Mr. Hackley replied affirmatively, but added that that statement, as well as several statements in the Congressional

Committee reports on the bill, might be hard to support in view of the literal language of the law. The President could exempt certain matters by Executive Order in the interest--to quote the law--of "national defense or foreign policy."

Mr. Daane remarked that the Committee obviously had thought in the past that it was not in the national interest to publish its directives currently. He was not questioning Mr. Hackley's legal judgment, but simply expressing the view that the Committee should give careful consideration to the point that if it was agreed that the law required publication of the directives it might be difficult to justify any particular time lag.

Mr. Brimmer said that at this stage he was not prepared to rule out the possibility of obtaining an exemption by Executive Order as quickly as Mr. Hackley evidently was. More generally, he would hope that the Committee would adopt a procedure that it thought consistent with the law and then, if necessary, stand ready to have its judgment tested in court. Moreover, he would hope that the Committee would take a cautious approach and not decide immediately that 60 days was the maximum defensible lag. Once such a decision was taken it would not be feasible to backtrack.

Mr. Mitchell asked whether the Manager thought a 60-day lag would be detrimental.

Mr. Holmes replied that publication of the directives after 60 days could lead to difficulties in that the market was likely to interpret the last published directive as indicating the Committee's current policy. On that basis, a three-month lag would be much better; after such an interval the actions were more likely to be thought of as a matter of history. As long as monetary policy was operating flexibly there might be risks in a 60-day lag.

Mr. Mitchell noted that the Committee had faced such risks in the past when its policy record was published, but of course that had occurred only once a year.

Mr. Wayne agreed that there was a real danger that serial publication of the directives might lead the market to believe that the last directive published reflected current policy.

Chairman Martin then suggested that the members of the Committee continue to think about the matter and plan on discussing it further at the next meeting.

Chairman Martin then noted that at its preceding meeting the Committee had agreed to hold a further discussion today of criteria for increasing membership in the Federal Reserve network of reciprocal currency arrangements. In accordance with the

Committee's request, memoranda had been distributed on the four countries under consideration, namely, Denmark, Norway, Mexico, and Venezuela, on February 28, 1967.[1] The Chairman asked Mr. Solomon to open the discussion.

Mr. Solomon said that the four papers examined the countries concerned from the point of view of the criteria set forth in the earlier staff memorandum, which the Committee had discussed at its previous meeting. A few additional but related criteria were also applied, including political stability and creditworthiness. It was clear from the papers that only one of the four countries was now eligible on the basis of the criteria used--only Mexico's currency was convertible within the meaning of Article VIII of the Articles of Agreement of the International Monetary Fund.

Chairman Martin then invited Mr. Wayne to comment, noting that copies of some recent correspondence of his with staff members had been distributed to the Committee.

Mr. Wayne said his letter to Mr. Holland of February 23, 1967,[2] was prompted by his concern about a possible interpretation

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1/ Copies of these memoranda have been placed in the Committee's files.

2/ Copies of this letter, and of a letter of comment from Mr. Solomon to Mr. Wayne dated February 27, 1967, have been placed in the Committee's files.

of the earlier staff memorandum--and of some of the Committee's discussion at the preceding meeting--to the effect that the Committee should consider adopting some arithmetic or mechanical criteria for the inclusion of additional countries in the swap network. His contention was that System participation in the swap network had one overriding purpose, which was fairly well spelled out in the record of the Committee's actions in the foreign currency area--namely, to further the interests of the United States by contributing to the protection of the dollar and to the preservation of its role as an international currency. Accordingly, he thought that the System should enter into a swap arrangement with a particular foreign central bank only if doing so would be in the interests of the United States. The Committee, of course, had to exercise judgment in making such determinations, and if the conclusion was that a particular arrangement was in the interests of the United States he would be prepared not only to consider it but to authorize the Special Manager to seek it. If, on the other hand, the addition of a particular country to the network would appear not to have a material effect on the position of the dollar, he would prefer not to add that country even though doing so might improve its international status or perhaps contribute to diplomatic relationships. The Committee had the inescapable responsibility for determining whether particular actions were in the interests of the United States.

Mr. Coombs suggested that the Committee first concentrate on two of the countries in question, Denmark and Norway, from whom specific requests for swap arrangements had been received. In his judgment, it was virtually certain that they would achieve Article VIII convertibility by early April. Mr. Wayne had put a direct question that required a direct answer--namely, whether such arrangements would be in the interests of the United States. He personally felt that arrangements with Denmark and Norway definitely would be. First, with respect to the risk of gold sales, the Danes had bought gold in 1960, when the price on the London market broke out, and either country could change its gold ratio. Secondly, the swap network, by and large, had become focused on the Basle group of countries, which gave undue weight to the members of the Common Market. As he had indicated at the preceding meeting, it would be useful to dilute the influence of those countries by adding Denmark and Norway. The staff papers on the two countries--which he thought were excellent--suggested that they were stable financially, economically, and politically, and that they could be expected to observe the rules of the game.

Third, Mr. Coombs said, a network of credit lines with foreign central banks provided a nucleus for rounding up additional support for a country in case of need. Last September, when an effort was being made to round up $400 million of additional help for the Bank of England, it was found possible to raise only $350 million from the System's swap partners. The sum desired was obtained because the Danes and Norwegians contributed $50 million to the package even though they were not members of the network. Their sense of responsibility and their willingness to help deal with emergencies were evident.

Finally, Mr. Coombs said, while avoiding losses of gold was important to the United States, the swap network had the additional important purpose of protecting the international role of the dollar. In that connection countries with low gold ratios could contribute just as effectively as those with high ratios. The availability of the swap arrangement to them could help to reinforce their willingness not to buy gold.

Chairman Martin commented that Mr. Wayne had pointed up the question clearly. Assuming that Denmark and Norway achieved Article VIII status, he thought there would be no objection to including them in the network under the criterion that Mr. Wayne had mentioned.

Mr. Wayne said that he personally was persuaded by the comments of Mr. Coombs that the inclusion of Denmark and Norway would definitely be in the interests of the United States, assuming they met the Article VIII requirement. But to him that did not mean that any other country would necessarily fall in the same category.

Mr. Mitchell remarked that he would like to say a word in support of including the Latin American countries. The U.S. role in international financial affairs was not just a defensive one; the United States should be a positive force for the improvement of world economic conditions. If the swap network was extended only to the countries that foreseeably could help the United States, it would consist of an undesirably selective group. In his judgment, a failure to include Latin American countries, if they were able to qualify under Article VIII, would be a serious mistake. The Committee should recognize now that it would be desirable to include qualified Latin American countries.

Mr. Daane said he would underscore the point that the overly sharp focus on the Basle countries in the swap network had been adverse to the U.S. interest in the operations of the network and to the U.S. interest in encouraging the concept of a wider rather than a narrower group of countries in the discussions of international monetary reform. In his judgment, these factors argued for expanding the network. Mr. Wayne had made a good point in his letter when he suggested that the Committee should not be discriminatory in admitting new members. But it should be possible to keep the network open and at the same time act in a nondiscriminatory manner. Fairly well-developed criteria would help the Committee extend the network in an appropriate way.

Mr. Wayne agreed that the Committee should stand ready to extend the swap network and, indeed, should welcome opportunities to do so. His contention was that the Committee had to assume the responsibility for making determinations on a country-by-country basis.

Mr. Hayes commented that he agreed with most of what had been said. The staff had done the Committee a real service in working on objective criteria, but he shared the view that such criteria could only be aids to judgment. The Committee should not have rigid standards for admitting countries to the network; it should consider each case on its merits. On that basis, and with Mr. Coombs' comments in mind, he would favor proceeding in connection with Denmark and Norway when they complied with the requirements of Article VIII. Among the Latin American countries of major importance, only Mexico seemed to him to really qualify. Some of the statements in the staff memorandum with regard to economic and political conditions in Venezuela made him dubious about the desirability of including that country at present. He did not know whether or not this was the appropriate time to include Mexico. Having one Latin American country in the network would undoubtedly lead to some pressure to include others, but the Committee would have to face and resolve that problem at some point.

Chairman Martin suggested that the Committee authorize negotiations at this time with the central banks of Denmark and Norway looking toward their inclusion in the swap network. He did not think the Committee should turn its back on Mexico and Venezuela, but Mr. Robertson had made a good point at the last meeting when he suggested that it was desirable to proceed cautiously in enlarging the network. He thought Mr. Wayne had done the Committee a service in raising the questions he had.

Mr. Scanlon commented that he assumed that the completion of swap arrangements with Denmark and Norway would be conditional on their attaining Article VIII status, and Chairman Martin agreed.

Mr. Coombs raised the question of the size of the swap arrangements with Denmark and Norway that the Committee would consider appropriate. Noting that the smallest arrangement in the present network was $100 million, he suggested that he be authorized to propose that figure in the negotiations.

There was general agreement with Mr. Coombs' suggestion.

Mr. Solomon said he would like to make two points before the present discussion was concluded. First, the staff had tried in the memoranda to give the Committee some flavor of the political situations existing in the four countries in question. But the staff's remarks on that score should be considered against the background of the political situations in various countries that were already members of the network; not all countries now in the network had always been free of political instability. Secondly, he thought that before the Committee moved formally on swap arrangements with Denmark and Norway it would be desirable to consult with the U.S. Treasury and possibly also with the Department of State.

Mr. Coombs commented that he understood from discussions with Treasury staff members that they would have no objection and, indeed, would be pleased to have the System enter into the arrangements in question.

Mr. Wayne observed that since the System's swap network impinged on both international financial relations and diplomatic relations of the United States, inter-agency consultations would be desirable.

Chairman Martin then asked whether there were any objections to proceeding with negotiations with Denmark and Norway on the basis of the discussion today, and no objections were raised.

Chairman Martin then noted that the authorization for forward commitments in Italian lire in the amount of $500 million, contained in paragraph 1(C)2 of the authorization for System foreign currency operations, had last been discussed at the meeting held on November 22, 1966. It had been agreed at that time that the matter should be reviewed again after three months. In preparation for such a discussion today memoranda on the subject from the staffs of the Federal Reserve Bank of New York and the Board, both dated February 27, 1967, had been distributed to the Committee.[1/] The Chairman asked Mr. Coombs to comment.

Mr. Coombs said that he thought there could be very little question but that the forward operations in Italian lire had been successful. They had relieved pressure on the Bank of Italy to buy gold, and they had had the highly useful effect of channeling dollars back to the Euro-dollar market at a time when U.S. banks were reducing the volume of dollars they provided to that market or were actually pulling dollars back. The Treasury was willing to continue such operations, and the question before the Committee was whether or not the System should continue to participate in them along with the Treasury.

At the moment, Mr. Coombs continued, he had no firm view as to the length of time for which the forward commitments would have to be rolled over; that depended on developments in the Italian balance of payments. But as a general rule central banks were not particularly concerned about the duration of such operations. The time factor that was considered so important for maintaining discipline in connection with swap drawings simply

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1/ Copies of these memoranda have been placed in the Committee's files.

did not enter into this type of operation, since it was directed toward maintaining a desirable degree of ease in a particular money market, the Euro-dollar market. While the Committee became concerned when a swap drawing threatened to remain outstanding for more than six months, he did not think a similar limit should be imposed on these technical forward commitments. In general, he hoped that the System would continue to participate along with the Treasury and the Bank of Italy in this operation. It was useful in bringing the System into direct contact with the Bank of Italy and with the Euro-dollar market, and at the same time preventing a disruptive effect on the gold stock.

Mr. Solomon said that the Board's staff did not have any policy recommendations different from those of Mr. Coombs. In its paper it had tried to give the Committee some of the history of the Bank of Italy's swap operations with Italian commercial banks, to review some of the economic effects of those operations, and to outline some of the policy issues as it saw them. The matter was extremely complicated, both in terms of economic effects and policy questions.

One fact that came out of the staff's review, Mr. Solomon continued, was that the net foreign exchange assets of the Italian commercial banks against which the forward commitments were held consisted much more of claims against Italian residents than against foreigners. A second fact the staff thought worth bringing to the Committee's attention was that the Bank of Italy's swaps with Italian commercial banks had, indeed, kept down their official reserve accruals and reduced the pressure for Italy to buy gold from the United States. But an important element in that situation in 1966 was the fact that U.S. banks had been in the Euro-dollar market, absorbing the dollars which the Italian banks were putting in. If that had not been the case, the dollars might have gone to countries that had a greater propensity than Italy to buy gold. Accordingly, it could not be assumed that the operations in question would minimize U.S. gold losses under all circumstances.

The staff also had tried to consider what might happen if the System swap commitments were withdrawn, Mr. Solomon observed, although it was not suggesting such a course. The specific question examined was whether the Bank of Italy would then be inclined to reduce the volume of its swaps with Italian commercial banks. The conclusion was that the Bank of Italy might want to maintain those swaps in any event, to avoid the increase in lira liquidity that would result if the commercial banks converted their foreign dollar claims back into lire. Finally, it did not, by any means, appear certain that a shift toward deficit in the Italian balance of payments or a change in Italian monetary policy would automatically result in a reduction in the volume of the Bank of Italy's swaps. The relationships here were both complicated and loose. The problem was a complex one, with many conflicting considerations, and he would repeat that the Board's staff was not suggesting a course different from that recommended by Mr. Coombs.

Mr. Daane said that one alternative to U.S. forward lira commitments mentioned in the Board staff's memorandum--that of issuing additional Roosa bonds to Italy--had been explored from time to time but had met with complete resistance on the part of the Italians. Thus, he did not think it was a real alternative. Like Mr. Coombs, he thought the forward operations had proved extremely useful.

Mr. Hickman asked whether it was not true that funds going into the Euro-dollar market via Italy tended to flow to Britain. If so, that would be a desirable result from the standpoint of the United States.

Mr. Coombs replied that such funds had tended to flow both to Britain and to the United States.

Mr. Hickman then suggested that the Committee reconsider the operations in question every three months and plan on discontinuing them at any time when their results appeared to have become inimical to the interests of the United States.

Mr. Daane commented that the operations in question involved no risk to the System, and Mr. Coombs agreed. The latter added that the Treasury was prepared to take over the System's commitments if the Committee decided to discontinue them.

Mr. Mitchell noted that the System's forward lira commitments had been in existence for over a year, and asked whether that was consistent with the Committee's general policy in the foreign currency area of attempting to deal only with short-run situations.

Mr. Coombs replied that the commitments had run on primarily because the Italian balance of payments had continued in surplus. As he had mentioned in the discussion last November, he thought the Committee should review them from time to time. But he thought there was a real distinction between, on the one hand, swap drawings--which were extensions of credit and thus were appropriately kept to a short term--and, on the other hand, operations of the sort under discussion, which were undertaken in concert with a foreign central bank to help deal with conditions in an important money market while at the same time relieving the pressure on that central bank to convert dollars into gold. The purpose of the operation was to improve international liquidity.

Mr. Mitchell then commented that the difficulty he saw with an ad hoc approach, such as was involved here, was that it could lead to different treatments in the System's relations with each of its counterparts. If a particular operation with a foreign partner was found to serve a useful purpose, it should be undertaken; but once that was done the Committee should offer to enter into the same type of operation with each of its counterparts.

Mr. Coombs replied that he did not think any other central bank was interested in the sort of arrangement that had been made with the Bank of Italy.

Mr. Hayes remarked that in the five years since the System had undertaken foreign currency operations many possibilities had been explored with other central banks as efforts were made to devise procedures that suited particular situations. In the case of Italy, operations of the kind under discussion had been found useful. He did not think the Committee had precluded similar operations with others but, as Mr. Coombs had noted, evidently no other country was interested in them.

Mr. Daane said he thought the Committee would not want to broadcast the fact that it was willing to enter into some particular kind of operation. It was necessary to take into account the different approaches to reserve policies in different countries.

It was often desirable, he thought, to deal with particular problems by means of operations tailored in the manner found most useful to the United States and the other country concerned. It was his personal impression also that other European central banks were not interested in arrangements of the kind the System had made with the Bank of Italy. However, while he felt it would be unwise for the Committee to indicate that it was prepared to enter into such arrangements with any central bank, it should stand ready to consider any specific proposals made.

Mr. Brimmer agreed with Mr. Coombs about the usefulness of the forward lira operations. He thought the Committee should reject any suggestion that it would necessarily confine such operations to lire; the objective was simply to employ techniques that were useful in particular situations. As long as the Committee was not discriminating against any country, he would not want to see it dismantle a useful arrangement simply to achieve uniformity in the procedures followed with each partner.

Mr. Mitchell asked whether the System was not, in effect, giving the Bank of Italy a gold guarantee on dollar holdings by the forward commitments, and Mr. Robertson added that, if it was, the real question was whether it would be prepared to give a similar guarantee to all countries. If not, Mr. Robertson said, he did not think such a guarantee should be given to Italy. The longer the arrangement was continued the more difficult it would be to disengage from it.

Mr. Coombs replied that the System's forward lira commitments did not involve a gold guarantee which, he agreed, would be undesirable. The type of exchange guarantee involved was identical to that given in drawings under the swap arrangements. In a way, the essence of the System's foreign currency operations was to increase the willingness of foreign central banks to hold dollars without having gold guarantees.

Upon motion duly made and seconded, and by unanimous vote, the authorization for System foreign currency operations as amended on September 9, 1966, was reaffirmed:

AUTHORIZATION FOR SYSTEM FOREIGN CURRENCY OPERATIONS

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, and with the Bank for International Settlements:

Austrian schillings
Belgian francs
Canadian dollars
Pounds sterling
French francs
German marks
Italian lire
Japanese yen
Netherlands guilders
Swedish kronor
Swiss francs

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

(1) Currencies held spot or purchased forward, up to the amounts necessary to fulfill outstanding forward commitments;

(2) Additional currencies held spot or purchased forward, up to the amount necessary for System operations to exert a market influence but not exceeding $150 million equivalent; and

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

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

(1) Commitments to deliver to the Stabilization Fund foreign currencies in which the United States Treasury has outstanding indebtedness, up to $200 million equivalent;

(2) Commitments to deliver Italian lire, under special arrangements with the Bank of Italy, up to $500 million equivalent; and

(3) Other forward commitments to deliver foreign currencies, up to $275 million equivalent.

D. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for System Open Market Account with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)	Maximum period of arrangement (months)
Austrian National Bank	100	12
National Bank of Belgium	150	12
Bank of Canada	500	12
Bank of England	1,350	12
Bank of France	100	3
German Federal Bank	400	6
Bank of Italy	600	12
Bank of Japan	450	12
Netherlands Bank	150	3
Bank of Sweden	100	12
Swiss National Bank	200	6
Bank for International Settlements		
System drawings in Swiss francs	200	6
System drawings in authorized European currencies other than Swiss francs	200	6

3. All transactions in foreign currencies undertaken under paragraph 1(A) above shall be at prevailing market rates and no attempt shall be made to establish rates that appear to be out of line with underlying market forces. Insofar as is practicable, foreign currencies shall be purchased through spot transactions

when rates for those currencies are at or below par and sold through spot transactions when such rates are at or above par, except when transactions at other rates (i) are specifically authorized by the Committee, (ii) are necessary to acquire currencies to meet System commitments, or (iii) are necessary to acquire currencies for the Stabilization Fund, provided that these currencies are resold forward to the Stabilization Fund at the same rate.

4. It shall be the practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested insofar as practicable, considering needs for minimum working balances. Such investments shall be in accordance with Section 14(e) of the Federal Reserve Act.

6. A Subcommittee consisting of the Chairman and the Vice Chairman of the Committee and the Vice Chairman of the Board of Governors (or in the absence of the Chairman or of the Vice Chairman of the Board of Governors the members of the Board designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee his alternate) is authorized to act on behalf of the Committee when it is necessary to enable the Federal Reserve Bank of New York to engage in foreign currency operations before the Committee can be consulted. All actions taken by the Subcommittee under this paragraph shall be reported promptly to the Committee.

7. The Chairman (and in his absence the Vice Chairman of the Committee, and in the absence of both, the Vice Chairman of the Board of Governors) is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Secretary;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on such policy matters as may relate to the Secretary's responsibilities; and

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G (1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

10. The Special Manager of the System Open Market Account for foreign currency operations shall keep the Committee informed on conditions in foreign exchange markets and on transactions he has made and shall render such reports as the Committee may specify.

Upon motion duly made and seconded, and by unanimous vote, the foreign currency directive as adopted on June 7, 1966, was reaffirmed:

FOREIGN CURRENCY DIRECTIVE

1. The basic purposes of System operations in foreign currencies are:

A. To help safeguard the value of the dollar in international exchange markets;

B. To aid in making the system of international payments more efficient;

C. To further monetary cooperation with central banks of other countries having convertible currencies, with the International Monetary Fund, and with other international payments institutions;

D. To help insure that market movements in exchange rates, within the limits stated in the International Monetary Fund Agreement or established by central bank practices, reflect the interaction of underlying economic forces and thus serve as efficient guides to current financial decisions, private and public; and

E. To facilitate growth in international liquidity in accordance with the needs of an expanding world economy.

2. Unless otherwise expressly authorized by the Federal Open Market Committee, System operations in foreign currencies shall be undertaken only when necessary:

A. To cushion or moderate fluctuations in the flows of international payments, if such fluctuations (1) are deemed to reflect transitional market unsettlement or other temporary forces and therefore are expected to be reversed in the foreseeable future; and (2) are deemed to be disequilibrating or otherwise to have potentially destabilizing effects on U.S. or foreign official reserves or on exchange markets, for example, by occasioning market anxieties, undesirable speculative activity, or excessive leads and lags in international payments;

B. To temper and smooth out abrupt changes in spot exchange rates, and to moderate forward premiums and discounts judged to be disequilibrating. Whenever supply or demand persists in influencing exchange rates in one direction, System transactions should be modified or curtailed unless upon review and reassessment of the situation the Committee directs otherwise;

C. To aid in avoiding disorderly conditions in exchange markets. Special factors that might make for exchange market instabilities include (1) responses to short-run increases in international political tension, (2) differences in phasing of international economic activity that give rise to unusually large interest rate differentials between major markets, and (3) market rumors of a character likely to stimulate speculative transactions. Whenever exchange market instability threatens to produce disorderly conditions, System transactions may be undertaken if the Special Manager reaches a judgment that they may help to reestablish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. In such cases, the Special Manager shall consult as soon as practicable with the Committee or, in an emergency, with the members of the Subcommittee designated for that purpose in paragraph 6 of the Authorization for System foreign currency operations; and

D. To adjust System balances within the limits established in the Authorization for System foreign currency operations in light of probable future needs for currencies.

3. System drawings under the swap arrangements are appropriate when necessary to obtain foreign currencies for the purposes stated in paragraph 2 above.

4. Unless otherwise expressly authorized by the Committee, transactions in forward exchange, either outright or in conjunction with spot transactions, may be

> undertaken only (i) to prevent forward premiums or discounts from giving rise to disequilibrating movements of short-term funds; (ii) to minimize speculative disturbances; (iii) to supplement existing market supplies of forward cover, directly or indirectly, as a means of encouraging the retention or accumulation of dollar holdings by private foreign holders; (iv) to allow greater flexibility in covering System or Treasury commitments, including commitments under swap arrangements; (v) to facilitate the use of one currency for the settlement of System or Treasury commitments denominated in other currencies; and (vi) to provide cover for System holdings of foreign currencies.

Chairman Martin then noted that at a recent meeting the Board had given preliminary consideration to a draft review of System foreign currency operations in 1966 prepared by the Special Manager for inclusion in the Board's 53rd Annual Report. At that time it had been suggested that it would be desirable for the Committee to discuss the policy it would consider appropriate in the future with respect to publication of information regarding System foreign currency operations and the understandings that might be reached with other interested parties with respect to publication of information on particular operations. To provide the necessary background, the Board's staff had been asked to prepare a report on prior discussions of publication policy in the foreign currency area. The staff's memorandum, dated March 2, 1967, had been distributed to the Committee, along with copies of a letter from Mr. Coombs commenting on the reasons for the omission from the draft text of information concerning a drawing made by the Bank of Canada on its swap line with the System in the fall of 1966, and the reasons for limiting the information given on System operations in sterling during the course of the year.1/

Mr. Brimmer asked whether the issues that had been raised in the Board's discussion had not already been largely resolved.

Mr. Coombs replied affirmatively. He noted that the Bank of England had raised questions regarding certain figures included in an early draft that had been sent to them for comment and, accordingly, he had deleted those figures from the text sent to the Board for review. However, when the sterling situation took a turn for the better in late February the British attitude regarding publication became more relaxed, and the current plan was to include all of the data on sterling that had been questioned earlier. The sterling report would thus be complete. The Bank of Canada still preferred to have information on its 1966 drawing withheld at this time, but that information would be included in the Special Manager's next semi-annual report. Apart from that drawing, the only information that would not be made public concerning operations through the end of 1966 related to the dollar volume of the System's forward lira commitments.

1/ Copies of the documents referred to have been placed in the Committee's files.

Mr. Robertson commented that, looking toward the future, there was a question of policy in this area that the Committee should resolve, although not necessarily today. While he recognized the need for flexibility, he thought the Committee might want to consider presenting a statement along the following lines to each of its partners in the swap network:

> It is the general policy of the FOMC that all foreign currency operations in which it is involved, whether at its initiative or that of partner central banks, be disclosed within a reasonable period of time. The Committee intends to continue to publish information on Federal Reserve use of these facilities with a time lag of no longer than seven months.
>
> In addition, the Committee desires to propose to its partners in the network that they agree to a similar publication procedure by us with respect to their use of these facilities, with the understanding that exceptions will be made only after discussions between the Governor of the central bank proposing the exception and the Chairman of the FOMC.
>
> Final decision on this proposed procedure will be postponed until after consideration thereof by the partners in the network.

Mr. Daane commented that he did not question the desirability of full publication. He was concerned, however, that presenting such a statement to foreign central banks might affect their attitudes toward the swap network in a manner that would inhibit the most effective use of the network.

Chairman Martin, noting the lateness of the hour, suggested that the Committee plan on continuing the discussion of publication policy with regard to foreign currency operations at its next meeting.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, April 4, 1967, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

CONFIDENTIAL (FR)

Drafts of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on March 7, 1967

FIRST PARAGRAPH

The economic and financial developments reviewed at this meeting indicate some decline in industrial production and a marked slowing of expansion in over-all economic activity. Lack of growth in retail sales may be retarding adjustment of inventory accumulation from its recent excessive rate. Average commodity prices have changed little recently, but unit labor costs in manufacturing have risen further. Bank credit expansion has been vigorous and, after a period of rising interest rates and congested bond markets, financial conditions have again turned easier. Recent data suggest little improvement in the foreign trade surplus but also little increase in the outflow of U.S. capital. In several important countries abroad, economic activity has been softening for several months and monetary and fiscal policies have eased somewhat. In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions, including bank credit growth, conducive to noninflationary economic expansion and progress toward reasonable equilibrium in the country's balance of payments.

SECOND PARAGRAPH

Alternative A

To implement this policy against the background of the current reductions in reserve requirements, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the prevailing easier conditions in the money market, but operations shall be modified as necessary to moderate any apparently significant deviations of bank credit from current expectations.

Alternative B

To implement this policy against the background of the current reductions in reserve requirements, System open market operations until the next meeting of the Committee shall be conducted with a view to attaining somewhat easier conditions in the money market, and to attaining still easier conditions if bank credit appears to be expanding significantly less than currently anticipated.