MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, June 20, 1967, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Brimmer
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Scanlon
Mr. Sherrill
Mr. Swan
Mr. Wayne
Mr. Patterson, Alternate for Mr. Francis

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

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

Mr. Holland, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Molony, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Brill, Economist
Messrs. Craven, Hersey, Jones, Koch, and Partee, 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. O'Connell, Assistant General Counsel, Legal Division, Board of Governors

Mr. Williams, Adviser, Division of Research and Statistics, 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

Mr. Lewis, First Vice President, Federal Reserve Bank of St. Louis
Messrs. Eisenmenger, Link, Eastburn, Mann, Parthemos, Taylor, Tow, and Green, Vice Presidents of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Kansas City, and Dallas, respectively
Mr. Nelson, Director of Research, Federal Reserve Bank of Minneapolis
Mr. Deming, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Stiles, Senior Economist, Federal Reserve Bank of Chicago

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 23, 1967, were approved.

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 May 23 through June 14, 1967, and a supplemental report for June 15 through 19, 1967. Copies of these reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Coombs said that the Treasury gold stock was unchanged again this week, but the Stabilization Fund's gold balance was now down to $67 million and a transfer from the gold stock to the Fund might be required by the end of this month. While there were no sizable central bank orders in sight at the moment, the gold pool had lost a substantial amount--$68 million so far this month--and the deficit by month-end might well be higher. As the Committee knew, the U.S. share in the gold pool arrangement was 50 per cent, so that this country would be providing half of any further contributions to the pool.

Mr. Coombs noted that the pool's unusually heavy losses over the last month or so had been caused first by the cessation of silver sales, which led to some concern in the market that a similar move might be in the offing for gold, and subsequently by the Middle East conflict. Those developments had resulted in losses of $100 million over a five-day period in May and another $61 million on June 5 and 6. In particular, on June 5--the day of the outbreak of hostilities in the Middle East--intervention by the pool cost $41 million, which was by far a record for one day. To finance those losses, emergency arrangements were made by telephone for three supplementary contributions of $50 million each, thus enlarging the pool from $270 million to $420 million. As had been expected, there were difficulties with the French, who agreed to the first supplementary $50 million but accepted the second $50 million only for a two-month period and declined to participate at all in the third $50 million. As had been previously understood, the United States agreed to pick up the French share, and had taken the line that its commitment to hold the London price would be maintained, come what may. There was, however, growing concern among other pool members over the cost of the operation, and at each of the Basle meetings they continued to urge the U.S. to join in a fundamental discussion of longer-term solutions. The French clearly had concluded that the problem of dealing with the market price of gold was hopeless. If pressures continued on the pool--and he thought that was quite likely--it would be necessary to go back to the members for an additional $50 million since the pool's resources were down to $48 million as of today. He was hopeful that the additional $50 million could be obtained, but beyond that resistance was likely to increase.

There had been a good deal of activity in the exchange markets recently, Mr. Coombs continued. The recovery of sterling had been choked off around the middle of May by some poor trade figures for April and General de Gaulle's press conference, and later by the Middle East hostilities, and since mid-May the pound had barely managed to hold its own. In fact, at the end of May the British were seeking $100 million of window-dressing money to avoid showing a sizable reserve loss. In view of the distaste a number of Committee members had expressed in the past for that sort of operation, arrangements had been made for the U.S. Treasury to put up the $100 million on an overnight swap. For Federal Reserve account, however, market swaps of sterling (purchases of sterling for immediate delivery and concurrent sales of sterling for future delivery), with the Treasury joining in on a 50-50 basis, were initiated, with a total of $113 million made on June 1 and June 5. The Bank of England felt that those operations had been useful in helping to stabilize sterling at a critical moment, and he shared that view. Also helpful was the Bank for International Settlements drawing of $143 million on their swap line with the Federal Reserve in order to intervene in the Euro-dollar market, with the object of halting and reversing the sharp rise of rates in that market which was putting further pressure on sterling as well as widening the spread with U.S. rates. The sterling picture had looked a bit better since the release last week of the U.K. trade figures for May, which showed some improvement. However, the pound remained exposed both to large-scale conversions of Middle East money now held in London and to potential pressures arising out of the British effort to reflate their economy gradually.

With respect to the Middle East money, Mr. Coombs said, so far shifts of such sterling balances had been limited mainly to two large transfers totaling $65 million equivalent from sterling into Swiss francs. The New York Bank had been immediately informed of those transfers and in both cases it had suggested to the Swiss

National Bank and the Bank of England that they should try to finance them through bilateral arrangements, instead of involving the Federal Reserve through British drawings on their swap line with the System combined with Federal Reserve drawings on its Swiss franc swap lines. That position had been taken on the ground that such transfers of Middle East money might well prove irreversible, and accordingly the Federal Reserve would like to stand clear. If further sizable liquidations of the sterling balances should occur, and the British--as they were entitled to do--requested a drawing on the $1 billion sterling balance credit package, negotiated at Basle in June 1966, the System would become involved. However, he thought the United States might be able to provide most if not all of its 30 per cent share by earmarking for that purpose present Treasury and Federal holdings of $173 million of guaranteed sterling. In general, the British were now confronted with a new and potentially serious problem, which had to be watched very carefully.

Apart from the sterling transfers, Mr. Coombs observed, the Swiss franc had been in very strong demand, as usually happened in periods of crisis. Even before the Middle East hostilities, tight money conditions in Zurich had been pulling in money from abroad and repatriation of funds for the June 30 window-dressing date contributed further to the inflow. The Middle East crisis brought in another big wave of money--more than $170 million on a single day--and pushed the inflow of funds since the middle of May to more than $400 million, not counting the sterling transfers he had mentioned earlier. He had been assured by the Swiss National Bank that, in their view, the great bulk of the money coming in represented a repatriation of Swiss funds previously invested abroad. It had seemed to him that that fact provided the rationale for the System to draw as much as $370 million on its $400 million Swiss franc swap lines to absorb the inflow. If the Swiss view of the nature of the inflow was correct, he would hope that as international tensions eased there might be renewed outflows which would enable the System to reverse those drawings.

Subsequently, Mr. Coombs said, the System acquired $28 million Swiss francs from the Bank of England and paid down the swap drawings from $370 million to $342 million. Hopefully, substantial further progress in repaying those drawings would be made over the summer. More generally, however, he saw nothing to change the view he and Mr. MacLaury had expressed in earlier meetings that the System probably would have to make sizable drawings on a number of its swap lines during the summer months. Some of those drawings might prove difficult to reverse; if so, the United States might have to rely on an IMF drawing to arrange repayment.

Mr. Coombs then noted that at the March 7 meeting of the Committee it had been suggested that the Sommittee review the forward operations in Italian lire every three months. He regretted to report that there had been no reduction in $500 million of technical forward commitments outstanding. The one encouraging fact was that the Italian balance of payments position appeared to be in process of changing. Their surplus had fallen from $1.6 billion in 1965 to $700 million in 1966, and for 1967 it was likely to be in the neighborhood of $300 million. The Italians did not seem to be experiencing the usual heavy seasonal inflow at the moment, but they were likely to have some inflow in the summer months. As a result there was no likelihood of reversing any appreciable volume of the outstanding commitments over the next few months. If Italy experienced a deficit in the late fall some progress might be possible then in reducing the System's forward lire commitments.

In response to a question by Mr. Galusha, Mr. Coombs said he felt quite uneasy about the prospects for the pound over the summer, since it would be exposed to various kinds of pressures. The main source of encouragement was that, by virtue of the wage-price freeze and other actions last summer, the British had made much progress toward a more solid balance of payments position--their payments were in surplus in the first quarter--which had enabled them to ride through the recent difficulties as well as they had. If the Middle East crisis had occurred a year earlier, at the time of the maritime strike, the situation could have become hopeless overnight. Much depended now on whether Middle East balances were shifted out of sterling. Those balances totaled about $2 billion, a sizable sum. However, about $1-1/4 billion represented balances of Kuwait, and that country might very well decide it was to its advantage to keep those funds in sterling; if they were to scatter them around, in Swiss francs, gold, and so forth, they might find themselves much more vulnerable to a takeover by Iraq. The more aggressive members of the Arab League, including Egypt, Syria, and Iraq, were virtually bankrupt and had little money to move. Unless the Arab League managed to put together a solid front, which they had never been able to do in the past, the British losses should remain moderate.

Mr. Hickman mentioned that a British Government official recently had implied in conversation with him that the labor unions of that country were poised to demand another round of wage increases, which they considered to be long overdue. The official had suggested that the increases, which would be fairly substantial in certain areas, were likely to be granted. If so, that was likely to have some effect on market attitudes toward sterling.

Mr. Coombs remarked that he could not predict how the British Government would react to such union demands. They had recently obtained authority from Parliament for an extension of the wage-price freeze, however, and he had not detected any signs of weakening resolve on the matter in recent statements by Prime Minister Wilson and Chancellor Callaghan.

Mr. Hayes observed that the extended wage-price freeze had been authorized in a somewhat less rigid form than the original freeze and left open the possibility of some increases. The Government's objective evidently was to keep wages and prices reasonably under control, in the expectation that if necessary they would ask Parliament for another mandatory freeze. In his judgment, the Government was determined not to let wages and prices get out of control.

Mr. Brimmer commented that this matter had been discussed at some length in the course of the Paris meeting two weeks ago of the Economic Policy Commission. The British representative had indicated then that wages in the U.K. might rise about 6 per cent over the next 18 months.

Mr. Brimmer then noted that he had two questions. First, what was the British attitude toward the losses of sterling balances and what were their plans for coping with them? Secondly, Mr. Coombs had said that members of the gold pool were urging discussions of longer-run solutions to the problems the pool faced, but he gathered that the United States was not anxious to hold fundamental discussions of that type. Was the Treasury likely to agree to such discussions, or would they try to avoid them?

With respect to the first question, Mr. Coombs said that the British naturally were worried over the risk of large-scale liquidation of Middle East sterling balances. However, certain

British officials seemed to feel reasonably confident that by one means or another they might be able to dissuade the large holders--particularly Kuwait--from making massive conversions, since it was very much in the latter's interest not to do so. As he had indicated, if the balances were converted the British could request drawings of up to $1 billion on the sterling balance credit package. Such credits would be available for about nine months, after which the British could make a drawing on the International Monetary Fund. Ultimately, however, he thought the conversions would have to be charged off to British reserves.

As to the second question, Mr. Coombs continued, it was quite true that the United States had been trying to avoid a fundamental discussion of the gold pool arrangements. The most important reason was the present uncertainty regarding the outcome of the discussions of international monetary reform. It was conceivable that, if a reform plan were negotiated, the market would feel reassured that the official price of gold would be maintained, and that as a result the pressures in the gold market would subside. His personal view, however, was that the results of the current exercise would not make a great deal of difference. There was a strong possibility that the gold market problem would get worse. While a variety of suggestions had been made for dealing with it, there was still no agreement as to the most effective approach.

By unanimous vote, the System open market transactions in foreign currencies during the period May 23 through June 19, 1967, were approved, ratified, and confirmed.

Mr. Coombs then noted that at its preceding meeting the Committee had approved renewals for further periods of three months of the $50 million supplementary swap arrangement with the National Bank of Belgium and the $150 million swap arrangement with the Netherlands Bank on June 30, 1967, when those arrangements were scheduled to mature. Subsequently, the Belgians had indicated that they were prepared to combine the supplementary $50 million arrangement with the basic $100 million arrangement which had a one-year term and was scheduled to mature on December 22, 1967. In effect, there would be a single $150 million arrangement, maturing on December 22, and having a one-year term thereafter. Also, the Dutch had indicated that they were prepared to renew the arrangement maturing on June 30 for six rather than three months, and to give sympathetic consideration at its maturity on December 30, 1967, to shifting the arrangement to a one-year term.

Mr. Coombs went on to say that the recommendations he planned to make in connection with those two arrangements, and in connection with certain other arrangements that were scheduled to mature soon, were related to a more general recommendation that the Committee consider shifting all of the arrangements in the swap network--with the possible exception of that with the Bank of France--to full-year terms, maturing near the year end. Presumably, however, that more general recommendation should be discussed in connection with an item appearing later on the agenda for today's meeting, reading "Discussion of swap network maturity dates."

Chairman Martin suggested that the Committee proceed at this point to discuss the more general question that Mr. Coombs had noted was listed later on the agenda. In that connection, he observed that on June 9, 1967, there had been distributed a memorandum from Mr. Coombs to the Committee entitled "Maturity dates of swap lines with Common Market central banks," which had been prepared in response to the Committee's request at the preceding meeting.1/

Mr. Hickman commented that common annual maturity dates near the year end for the swap arrangements represented a compromise which in his judgment was much to be preferred to common quarterly maturities. Hopefully, the year-end renewals would be rather routine, although there might be some efforts at multilateral surveillance. In any case, he favored Mr. Coombs' general recommendation.

Mr. Mitchell remarked that the question of real importance seemed to him to be whether or not the Committee should submit to

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

multilateral surveillance, although it might not have much choice. It was a matter of indifference to him whether the swap lines had terms of three or six months, one year, or five years. But having all renewal dates occur at about the same time would create a kind of exposure that he thought the Committee should resist if it could. He did not see any advantage in shifting to year-end maturity dates, and he would place primary importance on avoiding the same maturity date for the various arrangements. If, however, it was not possible to avoid a common maturity date, he questioned whether a date near the year end would be best from the System's point of view because of the large movements of funds at that time in connection with window-dressing operations.

Mr. Coombs replied that he had come to believe in the course of the recent negotiations that there was very little the System could do to dissuade the Common Market countries from consulting with one another about their swap lines with the Federal Reserve, since the concept of consultation was rooted in the Rome Treaty. Moreover, he thought it would be unwise to try to dissuade them. In the recent discussions he and Mr. Hayes had objected, not to such consultations within the Common Market, but to their moving on to making firm and binding decisions affecting the network without prior discussions with the System. They had conceded that that was inappropriate, and had reversed the decision they had taken.

At the same time, their consultations would be more frequent if the present maturity dates were retained than if they were shifted to year end. In his judgment an annual multilateral surveillance exercise would be too infrequent to be very effective.

Mr. Coombs went on to say that he had given a great deal of thought to the question of what date would be best for swap line renewals if a common date was to be arranged. His conclusion was the opposite of Mr. Mitchell's; renewals near the year end seemed preferable to him. At that time, when flows of funds were large for strictly technical reasons associated with window-dressing activity, the swap network was of maximum usefulness to all parties and the System's partners were least likely to be inclined to take any drastic action affecting the network. While the System tended to draw on the lines around the year end more than its partners did, the latter recognized that a major reason for the System drawings was the seasonal pull-back of funds into their own credit markets and that the drawings had relatively little to do with the U.S. balance of payments position. The official operations around year end represented a joint effort to smooth out conditions in the international money markets in a period of seasonal strain.

Mr. Hayes commented that he recognized the points Mr. Mitchell had made but he thought that on balance the compromise proposal emerging from the negotiations was a reasonable one. He would stress that the negotiations had been difficult because the System was faced with a firm decision that had been taken by the Common Market members and that might well have led to frequent multilateral surveillance. It had been important for the Federal Reserve to take a firm stance in the matter, but it was obviously undesirable to drive the French into discontinuing their swap line. Common annual maturity dates seemed to be about as good a compromise as was possible. With respect to the particular date to be used, he agreed with Mr. Coombs that the year end was advantageous from the System's point of view.

Chairman Martin remarked that in the course of the recent Basle meeting he had talked with people from most of the central banks involved. From those discussions he had the definite impression that the point regarding the undesirability of their reaching binding decisions without prior consultation with the Federal Reserve had been well made. In his judgment the Common Market central banks probably would cooperate with the System on that matter in the future.

Mr. Wayne asked whether European central bankers still held to the earlier concept of the swap network as a mechanism for serving the mutual interest in maintaining an effective international payments system, even though in a particular period one country might draw on the lines substantially more often than others. If the swap network was viewed in Europe simply as a device for financing perpetual deficits in the U.S. balance of payments there would be little sentiment there for maintaining it, except as a benefit to the United States. The attitude would be different if it was recognized that the purpose was to maintain an international payments system beneficial to the whole group.

Mr. Coombs replied that the mutual advantages of the swap network were generally recognized, although attitudes varied among individuals. He thought that appreciation of the mutual advantages had been sharpened by the recent discussions; some central bankers had tended to lose sight of them in the course of all of the discussion of the U.S. balance of payments problem. Among the technical people with whom he dealt from day to day there was a clear understanding that dollars flowing into their countries could be coming from any of various sources and that the flows might be unrelated to the U.S. balance of payments position. Among those people, at least, there was full recognition that in the absence of the swap network the international payments system might be subject to much greater strains.

Mr. Brimmer said he was in a quandary with respect to the proposed common year-end renewal dates because he did not look upon it as an innocuous arrangement. At one time operations under the swap network had been viewed as essentially technical, but now it appeared that they were being escalated into Common Market politics. The great disadvantage he saw to common annual maturity dates was that they were likely to lead not simply to consultations but to multilateral surveillance of the System's network by the Common Market countries. Perhaps the network was now less useful to the Europeans; he suspected that they viewed it simply as a discount window at which the United States could draw and thus avoid taking difficult steps necessary to correct its balance of payments situation. He hoped the Committee would not treat Mr. Coombs' proposal simply as a technical matter, although it might represent a compromise necessary to preserve the network.

Mr. Brimmer added that he thought there should be advance consultations with the Treasury if the Committee planned to adopt common year-end maturity dates for its swap arrangements. He was prompted to make that suggestion because he had heard a complaint from a State Department staff member--not one at the top level--that the Federal Reserve had not properly informed that Department about the swap arrangement recently completed with Mexico. In fact, Mr. Robert Solomon had consulted in advance with the Deputy Assistant Secretary of State for Economic Affairs, who evidently had not informed all interested persons in the State Department.

Mr. Coombs agreed that the swap network had been escalated into Common Market politics at one point recently, but he thought that as a result of the firm stand taken by the System it had been de-escalated again. The Europeans now recognized that the System would react strongly to any effort to bring use of the swap lines under their joint control. In any case, they probably could not exercise any effective control on a once-a-year basis, particularly if renewals came at the end of the year when the existence of the swap network was of great importance to them as well as to the United States. As he indicated in his memorandum of June 9, the Committee could simply stand pat on existing maturity dates. However, that would offer more occasions for consultation than a new pattern of year-end maturities would.

With respect to Mr. Brimmer's second point, Mr. Coombs said that the Treasury was fully informed on the proposal for swap network maturities. He agreed that there might be some problem in keeping other interested Federal agencies informed.

Chairman Martin thought Mr. Brimmer's point was well taken that a shift to common annual maturity dates was not an innocuous matter. However, such a shift might well be unavoidable if the swap network was to be maintained. He thought Mr. Coombs had done an excellent job in the recent negotiations and he favored accepting the compromise Mr. Coombs now proposed, on the understanding that the Committee would watch further developments closely.

Mr. Mitchell said he was disturbed by the implication in some of the preceding discussion that a common annual maturity date was a desirable thing. Personally, he would favor seeking as much variety in maturity dates as could be achieved. Perhaps some swap lines could be put on a two-year basis. Indeed, if the swap lines served a useful purpose and were expected to be permanent they might have no definite maturities. Negotiations then would be limited to questions of drawings under the standby lines, and there would be little opportunity for the System's partners to attempt to act jointly against the System.

Mr. Coombs remarked that by moving to common annual maturity dates the System would be taking a large step toward putting the network on a more solid longer-term basis. As he had indicated, the System could not dissuade its partners from consulting among themselves, but he believed the key point--that there should be no binding agreements affecting the Federal Reserve without negotiation--had been won.

Chairman Martin thought Mr. Mitchell's point was good that the System should seek diversity in maturity dates to the extent possible. But he would view that as a goal for the future; at the moment he favored accepting what was obviously a compromise.

Mr. Hayes said he liked Mr. Mitchell's suggestion that the Committee might consider negotiating swap arrangements on a longer-term basis, and he agreed with Mr. Coombs that the present proposal would be a large step in a desirable direction. He had sensed a feeling on the part of the Europeans that the network would be in existence for a long time, which would explain why some of them were willing to lengthen the terms of the arrangements. He did not agree with Mr. Brimmer that the Europeans regarded the swap network solely as a device for the United States to finance its balance of payments deficits. That was the attitude of some Europeans, but others appreciated the mutual advantages of the arrangements.

Chairman Martin questioned the desirability of entering into indefinite swap arrangements. While the terms might perhaps be lengthened to two or three years, the Committee should think through the matter carefully before giving up definite maturity dates.

Chairman Martin then noted that Mr. Coombs had referred earlier to certain recommendations in connection with swap arrangements other than those with the National Bank of Belgium and the Netherlands Bank, and asked whether Mr. Coombs would indicate their nature.

Mr. Coombs said he would recommend in general that as each of the System's swap lines approached maturity an effort be made to change it to a one-year term ending some time in December. The patterns under which the shifts were made might vary; thus, some central banks might prefer to have the next maturity date set in

December 1967, with annual terms thereafter, while others might prefer a twelve-month renewal now, to be replaced near year end by a new twelve-month agreement maturing in December.

Mr. Wayne asked whether his understanding was correct that the System might propose that the next renewals be only until December in some cases where the other party was prepared to renew the arrangement for a full year.

Mr. Hayes remarked that that was a possible procedure if the Committee felt it would be desirable to have the whole network shifted to a coterminous basis, with all arrangements maturing annually in December.

Mr. Mitchell commented that for reasons he had indicated earlier he would not favor such a course. He thought no member would object to lengthening the terms to a full year, but he would prefer to see any arrangements maturing in, say, July 1967 renewed for the period until the following July.

Mr. Hickman said he was inclined to agree with Mr. Mitchell that whenever possible individual arrangements should be scheduled to mature some time after December, out of phase with others.

Mr. Coombs observed that the main objective of putting the whole network on the same renewal schedule was to avoid a situation in which maturity dates were synchronized for Common Market countries as a special bloc and were diverse for the others. In his judgment the System would be in a stronger bargaining position if annual consultations by the Common Market central banks were timed to coincide with the maturity dates of all of the other swap arrangements.

Chairman Martin noted that Messrs. Daane and Solomon, whose views it would be desirable to have, were attending the Group of Ten meetings in Paris at this time. Perhaps the Committee might limit its actions on the swap network today to those arrangements for which action was urgent. He asked Mr. Coombs to specify the arrangements for which decisions were required today.

Mr. Coombs replied that the two arrangements maturing on June 30, with the Dutch and Belgians, were the only ones that would reach the end of their terms before the next scheduled meeting of the Committee on July 18. Several other arrangements would mature shortly after that meeting, in the period from July 19 through July 28. Those included the $100 million, twelve-month arrangement with the Austrian National Bank, scheduled to mature July 26; the $450 million, twelve-month arrangement with the Bank of Japan, scheduled to mature July 28; the $100 million, twelve-month arrangement with the Bank of Sweden, scheduled to mature July 19; the $200 million, six-month arrangement with the Swiss National Bank, scheduled to mature July 20; and the two $200 million six-month arrangements with the Bank for International Settlements--for

System drawings against Swiss francs and against other authorized European currencies, respectively--scheduled to mature on July 20. In light of the preceding discussion, he would now recommend that the Committee authorize renewals of the arrangements maturing in July on the existing terms, with that action subject to review at the next meeting.

Mr. Wayne asked whether it would be possible to reopen the question of the maturity date of an arrangement later if it was renewed now for a six- or twelve-month period.

Mr. Coombs responded that an agreement could always be cancelled and replaced by a new agreement, if both parties concurred.

Mr. Hayes noted that the number of arrangements maturing in July was quite large. He asked whether it would be feasible to postpone final decisions on all arrangements maturing after July 18 until the Committee's meeting on that date.

Mr. Coombs replied that that could be done, although some of the maturity dates were close to July 18.

Chairman Martin then suggested that the Committee act today with respect to the Special Manager's recommendations on the swap lines with the National Bank of Belgium and the Netherlands Bank, on the understanding that Mr. Coombs was authorized to negotiate concerning renewals of the other swap arrangements he had mentioned, with final Committee action to be taken on the latter at the next meeting.

No disagreement with the Chairman's suggestion was voiced.

By unanimous vote, renewal until December 22, 1967 of the $50 million supplementary swap arrangement with the National Bank of Belgium, scheduled to mature on June 30, 1967, and its consolidation with the basic $100 million arrangement maturing on December 22, 1967, was approved, on the understanding that the combined arrangement would have a twelve-month term after December 22, 1967.

By unanimous vote, renewal for a further period of six months of the $150 million standby swap arrangement with the Netherlands Bank, scheduled to mature on June 30, 1967, was approved.

Chairman Martin then commented briefly on the recent annual general meeting of the Bank for International Settlements that he had attended, noting that he had had an opportunity during his stay in Basle to exchange views with a relatively large number of foreign central bankers.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering domestic open market operations for the period May 23 through June 14, 1967, and a supplemental report for June 15 through 19, 1967. Copies of both reports have been placed in the files of the Committee.

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

During the period since the Committee last met there have been cross-currents at work in the financial markets and substantial variations in interest rates. Open market operations generally succeeded in keeping money rates--at least the Federal funds rate and dealer loan rates--quite steady. Treasury bill rates, on the other hand, declined to new cyclical lows early in the period and then rose substantially as demand slackened off before the tax date. Rates on CD's and other short-term money market instruments also moved higher over the period. In yesterday's auction average rates of 3.57 per cent and 3.84 per cent were set on three- and six-month Treasury bills, respectively, 8 and 15 basis points above the averages set just before the last Committee meeting.

After a fairly extended rally early in the period, the market for Government notes and bonds turned decidedly weak last week. Yields on short and intermediate issues were generally up by 20 to 40 basis points on balance over the period, and by last Friday the tone of the market was becoming reminiscent of last August. The corporate market continues to be beset by a very heavy calendar, with yields there on the verge of reaching or breaking through last year's peaks. The calendar for June is already nearly a quarter larger than the record March total of public offerings, and there is a large and growing schedule building up for July and August. The municipal market was doing somewhat better for a while in recent weeks, but demand in that market has slackened and renewed apprehension has emerged with yields again on the rise.

There were no new specific developments over the period to explain the higher rate levels; the Middle East war had only a minor market impact. But the continuing uncertainties about the budget deficit, the weight of the corporate calendar, fears of tight money later on in the year, and above all the approach of the Treasury's heavy borrowing needs--of which last week's offering of Federal National Mortgage Association PC's was an unpleasant reminder--led to dealer attempts to lighten inventories at a time when market demand was slackening off and investors were, on balance, switching out of Governments into corporate bonds and PC's. Against this background, there were times last week when there was virtually no market in intermediate- and long-term Governments; dealers ran from offerings and some decided that now is the time to get rid of whatever inventories they may have.

The volatility of market expectations is becoming increasingly disturbing. Perhaps this is inevitable in a period such as the present, when basic expectations are for an upsurge in business activity later on and there are so many uncertainties about military spending and the state of the budget. A firm approach by the Administration and Congress to fiscal policy seems an absolute necessity if we are to have any sort of market stability in the weeks and months ahead. In the absence of such a stand at an early date, the memories of last summer on top of heavy corporate and Government demands for funds could bring about near disorderly conditions in the financial markets. Meantime we may have considerable movements of interest rates that may or may not be related to the real needs of the economy.

Looking to the period immediately ahead, the System will have to supply a large volume of reserves--a little more than $1 billion on current projections--to meet the seasonal needs of the July 4 holiday, and then begin to absorb reserves in size around the middle of July. With this reserve outlook there should be room for a substantial volume of purchases of coupon issues along the lines of those made early in the last period. On the whole, I think that our purchases of coupon issues were constructive, despite some highly exaggerated newspaper speculation about the intention of the Committee before the purchases got under way. Certainly rate developments in the past week should have disabused market participants of any feeling that the Federal Reserve is trying to peg interest rates. Operations in coupon issues when they are readily available as a regular part of our reserve supplying function can continue to contribute something to the flow of funds in long-term markets. But we cannot--and should not--expect that they will solve all of the problems. Above all, we should avoid creating so wide a yield spread between Governments and other long-term securities that we become the only buyer of Governments.

The Treasury's cash position has played, and will continue to play, a major role in market and reserve developments. Over the three-week period ended June 14 the Treasury had to reduce its balance at the Federal Reserve Banks substantially, supplying in the process an average of over $300 million in reserves to the banking system. Last Thursday the Treasury again had to borrow $87 million from the Reserve Banks. We expect the balance to get back to normal levels today or tomorrow.

The Treasury is, of course, getting very near the period of heavy cash drains. On our estimates at the New York Bank, there will be a need to borrow about $15 billion in new money in the second half of the calendar year, assuming a 6 per cent tax increase effective October 1 and about $2-1/2 billion of new PC's. The first bite will most likely be scheduled for payment sometime after mid-July, with an announcement likely just before or after the 4th of July holiday. It does not now appear likely that the Treasury will be offering a note in that operation. Given all the uncertainties about taxes and expenditures, the Treasury has not yet been able to firm up its plans. A large proportion of the needs--well over half--can be met from the issuance of tax bills, and another $3-1/2 billion could be raised from additions to the regular weekly and monthly Treasury bill cycle. While the timing of future cash financings cannot be closely fixed at the moment, the next round would probably be required in late August or early September. In addition to a July cash financing the Treasury will, of course, be announcing the terms of its August refunding on July 26.

All in all, Government financing will be a continuing problem for us as well as for the Treasury from here on out. While the preponderance of financing in the bill area will minimize even keel considerations, the mere size of the Treasury's financing job will tend to make the market very sensitive to any change in System policy unless resolute fiscal action is forthcoming. The Treasury's problems--and ours--will of course be compounded if satisfactory debt ceiling legislation is not forthcoming.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period May 23 through June 19, 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. In connection with the staff's oral reports, a set of charts (a copy of which has been placed in the files of the Committee) was distributed at the meeting.

Mr. Brill made the following introductory statement:

It's been more than four months since the staff presented to the Committee an appraisal of the Administration's economic model, along with our own best guesses for the first half of the year and some perspective or the financial consequences of projected economic developments. Looking back on the record, I would say that the staff's near-term pessimism was borne out by the sluggish performance of the economy during the winter. Indeed, for the first half year as a whole, the rise in GNP appears to be coming out within a hairsbreadth of our earlier projection. Nevertheless, it now appears that recuperative forces are setting in somewhat earlier and with somewhat greater vigor than we had anticipated. This is in no small part a reflection of the extent to which Federal spending has exceeded January budgetary estimates, thereby sustaining private incomes at a better pace than we had projected.

In the financial area, we have been witnessing, as predicted, strong demands in capital markets and a letdown in demands for bank credit after peak tax pressures passed. But demands for long-term funds are persisting longer than expected, and market anticipations of economic resurgence and renewed monetary restraint are so firmly inbedded that capital market pressures show little sign of abating.

The starting point for today's fresh look into the months ahead, then, is an economy just about shaking off the effects of 1966 excesses, operating under stronger fiscal stimulus but also under more financial restraint than we had expected, in January, to be the policy mix in June. Critical to any appraisal of the outlook is the likely size of the fiscal stimulus in the months ahead. Today, we are departing from our usual custom of adhering to official estimates of defense spending. It's not that we've been blessed with any new military insight. Rather, it's because it seems highly unlikely that defense spending will abruptly level off at the current quarter's rate--which is about what would be required to stay within the Budget total. Something above the Budget--and guesses around town range from $1 to $6 billion--seems inevitable, short of major easing in the military situation. We've opted to test a middle course, by assuming that defense spending will total some $4 billion above the $72-1/2 billion budgeted. We have no way of knowing if this is in the right ballpark, but it does seem more realistic, at the moment, than assuming an immediate leveling off in defense spending. And we've also assumed a moderate social security increase--8 per cent--effective October 1 and paid out of the trust fund's surplus.

Against this fiscal stimulus we've pitted a restraint package that seems like a reasonable program to expect of the Administration, the Congress, and the Federal Reserve. On the fiscal side, it assumes a 6 per cent tax increase, effective October 1 for individuals and retroactive to July 1 for corporations. On the monetary side, it assumes intermediate- and long-term rates at roughly present advanced levels, but with Treasury financing demands pushing up short-term rates to the point where they moderate, but do not significantly impair, savings flows to thrift institutions. In other words, monetary restraint in this model would stop short of jeopardizing a continuing, though moderate, recovery in the housing industry.

We turn first to an assessment of how this policy package would interact with demands to affect total output, the composition of output, resource utilization, and prices, which Mr. Koch will discuss.

Mr. Koch then made the following statement:

Our staff view of the outlook suggests that the period of slow economic growth we have experienced since early this year may be just about over. We are estimating a GNP increase of almost $65 billion over the next 4 quarters--a substantially larger gain than over the past year. Growth in constant dollar GNP would be about 5 per cent.

We would expect production and employment to start increasing this summer, followed shortly thereafter by an upturn in capacity utilization and a downward drift in the unemployment rate. But prices also seem likely to rise a little faster, with food price increases added to an updrift in industrial prices.

In the third quarter, the GNP increase is expected to be about $14 billion, or 4.5 per cent in real terms. In the fourth quarter, despite the assumed tax increase of 6 per cent, GNP growth should advance further by something over $17 billion. While the tax increase does act as a restraint, its influence serves mainly to moderate what otherwise would appear to be an even more expansive situation. The effects of the higher taxes on consumer incomes would be partly offset by increased social security benefits, and for business a partial offset has already been provided by reinstitution of the investment tax credit. However, the effects of the tax increase would help limit GNP gains in the first two quarters of next year, possibly to a little below the fourth-quarter rise.

GNP gains over the projection year are likely to come increasingly from private spending with less dependence on Federal defense outlays. By the second quarter of 1968, the rise in defense outlays would shrink to $1/2 billion--if there is no further escalation in Vietnam and if the $4 billion excess over the Budget estimate for fiscal 1968 that we assume turns out to be about right. Increases in defense spending this small might seem implausible in light of the large quarterly increases since early 1966. But the trends of military contract awards and the projected leveling out in the armed forces strongly suggest that a slower rise of defense outlays is quite possible.

Given this decelerating stimulus from defense, and given the assumed tax increase, how do we explain our forecast of excessive demand on resources? The answer, it seems to me, is found in large part in the evidence regarding inventories and final sales.

Final sales have been relatively strong in the first half of this year--increasing about $15 billion each quarter. They are expected to maintain this rate of growth over the next year. But in contrast to the first half, when GNP growth was reduced by the sharp slowing in inventory investment--by $11 billion in the first quarter and about $6 billion more in the second--this inventory drag seems about over. By the end of the third quarter, inventories are likely to be in better balance with sales, setting the stage for a modest resumption of inventory accumulation.

The continued strength in final sales depends on a number of factors. One of these is a projected rise in housing expenditures. In this connection, the recently announced larger May housing starts figure is encouraging. The expansion in housing may be dampened somewhat by currently high long-term interest rates, but demands for lodging are expected to continue strong. The projection implies starts rising to 1.4 million units, annual rate, by the fourth quarter, and leveling out at about 1.5 million in the first half of next year.

Our estimates for business fixed investment show small increases in both the third and fourth quarters of this year, in line with the latest Commerce-SEC survey. This survey was conducted in April and May, after capacity utilization had declined and first-quarter profits had fallen, and before the reinstatement of the investment tax credit was definite. In the first half of next year, with economic activity high, corporations in a more liquid position, profits increasing, and the capacity utilization rate rising, business investment expenditures are projected to continue expanding at a moderate rate. This is likely despite high corporate bond yields and the depressive effects of the tax increase on corporate profits.

Rising consumer outlays became an important factor in maintaining economic activity this spring. Retail sales of nondurable goods have picked up, and automobile sales have also shown some strength recently. Expenditures for services have continued to rise rapidly in both real and dollar terms.

Underlying the upturn in consumer buying have been large gains in disposable income. Incomes are expected to continue to grow fairly rapidly, as manufacturing and construction employment begin to rise in response to increased activity, and as wages advance further.

With this favorable income experience, it would seem likely that the upward trend in consumer spending on nondurable goods and services should continue, and we also project a rise in domestic automobile sales to an annual rate of about 8.5 million units by mid-1968--a high rate but still below the levels of 1965 and early 1966. Spending for other durables should also rise, in part associated with the recovery in housing.

All in all, the pattern is not one of any surge in consumer spending, but of gradual rise at a pace somewhat faster than in incomes. This would result in a downdrift in the savings rate from the very high first-quarter rate of 6-1/2 per cent to about 5-3/4 per cent by mid-1968.

Perhaps the most important factor underlying the ability of the economy to pull through the first-half inventory adjustment with minimal repercussion has been the trend in the Federal Budget deficit. On a national income account basis, the deficit in the first half of this year averaged $12 billion, annual rate, as against only $2 billion in the second half of last year.

Over the next fiscal year, as noted earlier, the increase in Federal expenditures for defense is assumed to taper off, but a rising level of grants-in-aid and higher transfer payments, in part reflecting increases in social security benefits, would be adding to total Federal expenditures.

Federal receipts would also pick up, reflecting rising individual incomes, rebounding corporate profits, and the effects of the assumed 6 per cent tax surcharge. Consequently, while the deficit in the last half of this year is expected to be close to a $10 billion annual rate, it would be tending downward toward less than $5 billion in the second quarter of next year.

The 5 per cent growth in real GNP projected over the next four quarters should soon reverse recent downward trends in production and employment, and use of both physical and manpower resources would become more intensive.

Industrial production, which has declined by 2 per cent since the peak in December, is projected to being rising again in the third quarter and to be 7 per cent above current levels by mid-1968. Meanwhile, additions to capacity, at about a 5 per cent annual rate, would be somewhat less than the rise in output, and the rate of capacity use in manufacturing would move up to about 87 per cent by the second quarter of next year.

Moderate declines in total employment have occurred since January. But there has also been a substantial slowing in labor force growth, so that the increase in the unemployment rate has been very small. We expect the unemployment rate to go up temporarily this summer as young people leave schools to look for work. But the increase in output projected by mid-1968, even assuming a return to a more normal rate of productivity gain, would require almost 2 million additional workers--somewhat more than the likely increase in the labor force. The unemployment rate, therefore, should be about 3.7 per cent by the second quarter of 1968--near the recent low.

More intensive use of the current work force as activity expands, increased capacity utilization, and the continuing introduction of new and efficient equipment should boost output per manhour. We expect productivity in manufacturing to increase at about a 3 per cent rate over the next four quarters--close to the average rate between 1962 and 1965.

But the outlook now appears dim for the cost and price stability that graced those earlier years. With demands for labor strong, the supply of labor relatively tight--especially for skilled workers--and the cost of living up substantially over the past year or so, upward pressures on wages should continue. We are projecting hourly compensation in manufacturing to increase about 4-3/4 per cent over the next year, somewhat faster than over the past twelve months. This would be more than the rise in productivity and result in a continued advance in unit labor costs, although at a pace slower than over the past twelve months.

Inasmuch as the sizable increases in unit labor costs of the past year have not yet been reflected in higher prices and some further upward pressures on such costs are likely, industrial prices may be expected to rise somewhat faster in the period ahead. In addition, prices of farm products and foodstuffs are expected to move up. It also seems probable that sensitive commodity prices will strengthen as manufacturing production starts to rise again.

Some of the step-up in wholesale prices should carry over to the retail level. With food prices up sharply, the consumer price index should rise more rapidly, perhaps as much as 3 per cent from mid-1967 to mid-1968.

In sum, we don't think the price line can be held if the economy accelerates to a 5 per cent or more real growth rate over a protracted period, particularly since it is starting from a still high level of resource use and with a heritage of wages lagging profits for several years and prices lagging labor costs over the past year.

Mr. Brill will now translate these projections of the real economy into financial flows and discuss their implications for current policy.

Mr. Brill continued with the following comments:

The financing needs generated by an accelerated rate of economic growth would be large indeed. Total funds raised--consistent with our expenditure estimates and policy assumptions--would be in the $80-$85 billion range, annual rate, in the two half-years of the projection period. Thus, we would be returning to the magnitudes of credit expansion experienced in the first half of 1966. Since expenditures would be higher than in the earlier period, however, the ratio of credit growth to GNP would be below earlier highs.

Borrowing by the private sectors would remain high but not contribute much to the rise in financial flows. Virtually all the increase in expected borrowing would be coming from the Federal sector. The Government's turnaround from net repayment of debt to very large incurrence of debt adds some $25 billion of demand to financial markets between the first and second halves of 1967. And Federal borrowing (which on the flow-of-funds basis used here includes sales of participation certificates) would continue relatively large even into 1968. The Treasury's debt management problems have been aggravated by the steep decline in the cash balance this spring, and the amount of Federal borrowing projected allows for an increase in the Treasury cash balance over the fiscal year of about $3 billion.

After remaining at about current levels for the balance of this year, borrowing in the private domestic sectors is projected to rise moderately in the first half of 1968. This reflects mainly the more rapid increase in mortgage debt needed to finance the further rise in housing activity projected. But with business capital outlays and consumer durables purchases projected to advance only moderately, and with corporate profits showing good gains, private borrowing remains below its pace of 1965 and the first half of 1966.

Total borrowing of the business sector is projected to remain as high as the average 1965 rate, but well below the levels of the first halves of 1966 and 1967. There are a number of reasons for expecting less frantic total credit demands by businesses--inventory accumulation remains relatively low, fixed capital outlays rise only gradually and by less than depreciation allowances, profits are expected to rebound, and the period of accelerated tax payments is now behind us.

But in projecting the forms in which businesses will seek external financing, we have to look forward to a continued heavy volume of business security issues through most of the second half of this year. The current corporate calendar alone seems to insure that for several months ahead.

However, we are hopeful of some relief for the congested corporate security market by or after the turn of the year, in the expectation that liquidity demands of businesses will, by that time, be less urgent. Moreover, business credit demands in 1968 should be such as to focus more heavily on the banking system, principally because inventory financing needs pick up, while capital outlays rise only moderately.

The continuation during the second half of this year of large corporate security issues, together with the large volume of municipal financing already scheduled or known to be waiting in the wings, and the massive amount of Treasury borrowing to be undertaken, would provide a severe test for financial markets and monetary policy. In considering what the appropriate stance of policy should be with respect to interest rate pressures that might emerge, it seems to us that a principal consideration must be the potential effects of rising interest rates on flows of saving to thrift institutions.

Net inflows to these institutions rose to an annual rate of over 9 per cent in the first half of this year. Some reduction from this rate would still permit financing the housing activity projected in the GNP model. But a significantly larger reduction than that projected here would call into question the potential revival in housing--and could, of course, once again threaten the liquidity of some of the shakier savings and loan associations.

Despite the high level of institutional flows in recent months, we may already have gotten fairly close to the trigger point where saving flows begin to be diverted to market instruments. Yields on corporate new issues already have returned to within about 20 basis points of the high recorded last fall. And on intermediate Governments, yields in recent days have risen sharply to the 5 per cent level. If rates in these sectors of the market were to rise much further, it seems inevitable that savings inflows to nonbank thrift institutions would soon begin to decline and mortgage yields--which have already turned up--to increase further. The results in the housing market would be evident before very long.

Some further upward adjustment in short-term rates, however, could probably still be accommodated. A gradual rise in Treasury bill rates, say, to about the 4.25 - 4.50 range projected by the end of this year, might be absorbed without communicating great pressures to yields on intermediate- and long-term instruments, if market psychology were tranquilized, perhaps by evidence of forthcoming tax action and by continued coupon-buying by the System.

Nevertheless, if financial markets are to be cleared at roughly the present level of prices, there will be a big job to be done by the banking system. Even with a still high volume of personal saving, and even with continued large corporate reinvestment of capital market proceeds in liquid assets, the spill-over of Federal and private financing demands generated in this model would be such as to require continued rapid expansion in bank credit if rates are to hold at present advanced levels. Our projection of bank earning asset growth consistent with the GNP model and the interest rate structure assumed implies a rise somewhat faster over the balance of the year than in the first half--although not as fast as in the first quarter. Roughly half of the expansion in total bank credit during the next six months would reflect acquisition of Governments. With loan demands remaining generally low, banks could also continue to provide active support for the municipal market.

During the first half of 1968, bank credit growth is projected to be somewhat smaller, as Treasury financing needs moderate. Partially offsetting the reduction in Federal financing demands would be some revival in business loan expansion, as a return to inventory accumulation restores some traditional financing patterns. Perhaps this loan expansion might commence sooner, if banks feel impelled to woo customers back from the capital markets.

The percentage growth rates of bank credit projected for the year ahead, though large, are not exceptional by the standards of the past several years. The increase in bank credit for the second half of this year is at an annual rate of about 10 per cent--and it is this high partly because Treasury deposits are projected to rise substantially during the period. The rate then falls to below 8 per cent in the first half of 1968. Putting these flows into somewhat broader perspective, the share of bank credit in total credit flows would be declining throughout the projection period, averaging about one-third of the total for the fiscal year as a whole.

The growth in money balances consistent with the GNP and interest rate projections we would judge to be about a 4-1/2 per cent rate over the full year. Meanwhile, time deposit growth would fall to the 11 - 12 per cent range--reflecting some diversion of consumer asset purchases into market securities, and a relatively unaggressive posture of banks in bidding for CD's.

These are not high rates of private deposit accumulation, but they do imply that substantial additions to reserve balances would be needed--especially during the second half of this year. Reserve needs would be magnified by the changing composition of deposits, with a large rise in Treasury demand balances from currently low levels projected over the next half year.

These, in summary, are the main features of a financial structure consistent with the underlying GNP projection. The problems the model as a whole poses for the Committee are serious. The analysis suggests that the postulated restraint package--a 6 per cent tax increase and continued high cost of borrowed funds--would not be adequate to counteract all inflationary pressures in an economy spurred by re-emerging strength in private demands plus further military demands on resources. Given the lags in monetary policy effects, if we were convinced that the net fiscal stimulus in the model were the most probable development, we should be cranking up to a greater degree of monetary restraint than has been built into the projection.

But the costs of acting on this conviction would also be serious. We are on the verge of a major dividend-crediting period for thrift institutions, with the returns available on some competing market instruments already crowding the rates offered savers by these institutions. And we have made no significant progress in modifying the mechanism which last year channeled the major brunt of monetary restraint onto thrift institutions and the housing industry. With the housing surplus already depleted, it would seem poor economics, as well as irresponsible public administration, to permit a repetition of 1966. Avoiding a replay, in the absence of adequate fiscal restraint and without resort to selective controls, would require substantial provision of reserves to accommodate the soaring credit demands from the Treasury.

The general problems we are portraying as possible over the months ahead are epitomized in the blue book's[1/] picture of the immediate weeks ahead. Assuming the debt ceiling hassle is resolved in some viable manner, we are expecting large Treasury financing in July; the corporate and municipal calendar is exceptionally large; bank loan demands are

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

likely to be moderate. And in this period, we--and financial markets--will probably remain in the dark as to the size and timing of future tax actions and as to the scale of military spending plans.

Given these fiscal uncertainties, and weighing the hazards of premature action, the "wait and see" policy assumed in the blue book--and suggested in the draft directive[1/]--seems appropriate to me, at least for the next month. This policy would have the System provide the reserves needed to support bank underwriting of the Treasury's financing, and provide enough of these reserves through coupon buying to forestall any worsening in capital market attitudes. But it would eschew any attempt to roll back rates, either through massive purchases of long-term issues or by a discount rate reduction, until a clearer reading on the fiscal picture is possible. Hopefully, this will not be too long in coming. If this sounds reminiscent of late 1965, it's deliberate. But I do think that the lessons of 1966 have been learned by all policy makers.

Of course, the domestic hazards of alternative policy courses are not the only ones this Committee must weigh. Mr. Hersey will now discuss the balance of payments implications of the projection.

Mr. Hersey then concluded the presentation with the following comments on the balance of payments:

Predicting the balance of payments is especially tricky at a time of transition from one set of demand conditions here and abroad to another. Over the next twelve months we expect the trade surplus to stay near its April rate of about $5 billion, well above the average of the two preceding quarters. Given the present situation of U.S. manufacturers, with large stocks of products and materials and with delivery periods shortened, imports should not be rising much in the next few months. But since the competitive position of U.S. products in relation to imports may have deteriorated these past two years, perhaps we

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1/ A draft directive submitted by the staff for Committee consideration is appended to this memorandum as Attachment A.

will not get much cyclical decline either. Given the present weak demand conditions in some major countries, merchandise exports are unlikely to rise rapidly further for a while. By year-end, both imports and exports may be rising briskly.

Probably we can still assume that the interest equalization tax and the various semi-voluntary programs will help to prevent any large increase in private capital outflow in the next twelve months. Possibly U.S. credit conditions and the growth policies of the large U.S. banks will help to keep their outstanding liabilities to the Euro-dollar market near the present amount, so that perhaps flows on that account will be small. Military expenditures abroad, which were under $3 billion a year up to 1965, are now rising above $4 billion. Including guesses for Government loans and grants and other elements, we reach a range of $1 billion to $3 billion for the deficit on the official reserve transactions basis during the next twelve months. Despite all uncertainties, I am afraid we can be pretty confident that the balance of payments problem will still be with us a year from now.

At this moment of transition, looking ahead to a period of renewed economic growth and back to the years since the balance of payments problem emerged in 1958, progress toward equilibrium seems to have stalled. It may even seem questionable whether any net progress has been made toward a true equilibrium, considering the tying of foreign aid and the use we are making of moral suasion in place of ordinary economic incentives. So far as trade is concerned, it is extremely discouraging that imports rose as much as they did from mid-1965 to late 1966. However, much of that import bulge was connected not with long-run factors but with short-run boom conditions of demand in the United States; our manufacturing capacity utilization rose to 89 per cent in 1965 and 91 per cent in 1966; further evidence of excess demand was given by inventory investment in 1966. Such boom conditions as those are not foreseen in the next twelve months.

On the export side, increases over the past two years are not large enough to be really encouraging. But here again cyclical factors play a role. Downturns in German and British industrial production last year preceded ours and upturns have not yet been achieved. Revival in Germany, when it comes, will have multiplied effects on world trade through encouragement of demand expansion elsewhere. Thus

I would conclude that there is still a chance of getting lasting gains in the merchandise trade surplus over its present level. With a new improvement in investment income from abroad and an eventual shrinkage in U.S. military expenditures abroad, that might mean, some day, a significant enlargement of our balance of goods and services. For the next twelve months, however, net exports of goods and services may hold near a $6-1/2 billion rate.

The program of the United States Government, including the Federal Reserve, for working toward balance of payments adjustment has had--aside from great efforts at statistical prettification--four main elements: moral suasion as an interim measure; a modification of certain interest rate incentives by means of the IET; some economization, wise as well as unwise, in the Government's spending and lending abroad; and maintenance of price stability in the hope of improving the competitive position of the United States. The fourth element, price stability, is of course a very basic one. In view of the lack-lustre behavior of the trade balance after 1964, and in view of price developments since then, must we say that this program has been a failure?

From 1960 to 1965, there did seem to be a relative lowering of our price level for some sorts of manufactures important in international trade, but in relation to Germany, at least, the narrowing of the gap then began to be reversed. German prices for producers' equipment have actually fallen since last summer. An advance of 3 per cent in the United States GNP deflator index over the next twelve months, as projected, would have troublesome long-run implications.

For the shortrun, however, a good deal of encouragement can be drawn from the projection that average manufacturing capacity utilization will remain in the 85 to 87 per cent range. Experience seems to show that so long as this ratio stays below 87 per cent or so, not only does the short-run income elasticity of imports remain moderate, but also competition can be pretty effective in holding down prices of internationally traded goods.

For monetary and fiscal policy concerned with the balance of payments, the crucial short-run problems will be to keep industrial output from threatening to rise unsustainably fast and yet to keep fixed investment at a high proportion of GNP, so that the cushion of reserve capacity can continue to grow with the rest of the economy. The greater our success in these respects, the better our chance of improving the current account surplus in the balance of payments.

Over the longer pull, balance of payments adjustment is going to have to work through the capital account, too. Advances in U.S. interest rates over the past few years, matched as they were by similar changes in other countries, were of little avail. But if, over the next few years, Germany and other European countries can move their long-term interest rates down a long way, as a result of capital market reform and fiscal policy changes, while at the same time U.S. interest rates rise somewhat, a fundamental change in relationships can conceivably take place. Then, if U.S. corporations continued to build up direct investments abroad, they would finance them more and more with European savings. And Europe would take over from us more of the burden of supplying short-term credit to countries like Japan and long-term capital to the less developed countries. My personal opinion is that balance of payments equilibrium cannot be restored at present exchange rates without important changes here and abroad in the next few years in capital markets. The rise in U S. long-term interest rates this year may seem undesirable from some points of view, but it may count as a contribution toward long-run equilibration of payments.

Mr. Hickman asked whether the balance of payments projections included allowance for the possible effects of the Middle East crisis on U.S. oil exports.

Mr. Hersey replied in the negative. He added that the Middle East crisis was not likely to have much net effect directly on the U.S. balance of payments. The question was whether it would have serious effects on the payments situation of the United Kingdom and thereby an indirect effect on the U.S. payments position.

Mr. Robertson asked whether allowance had been made for the outflow of funds that were being collected in this country for Israel.

Mr. Hersey replied in the negative, noting that there was a high degree of uncertainty in connection with many types of capital flows, of which the flows in question were just one more element.

Mr. Brimmer asked whether the balance of payments projection assumed that the present program of foreign credit restraint would be continued with essentially the same structure and content. On receiving an affirmative reply, he noted that any change in the program that exempted credits to certain countries would result in a poorer payments performance than indicated. He then observed that the projection had been limited to the balance on the official settlements basis and asked why prospects for the balance on the liquidity basis had not also been considered. He was not aware that the Committee had agreed to consider either of the two bases of calculation as the appropriate one.

Mr. Hersey responded that the main reason for not attempting to project the balance on the liquidity basis was that it was affected by shifts of foreign official funds and funds of international institutions into near-liquid assets--shifts that were both extremely difficult to predict and not really significant. As he had noted at other Committee meetings, the liquidity basis of calculation resulted in an understatement of the real deficit when shifts of those types occurred. It seemed to the staff that the official settlements basis provided a good measure for a future period in which, it was assumed, the net movements of foreign commercial bank and other private liquid funds would be small.

Mr. Hayes expressed agreement with the thrust of Mr. Brimmer's question. He thought the Committee should keep a close watch on both guides to the U.S. balance of payments, and he assumed that the staff did so.

Mr. Mitchell asked if Mr. Brill would comment on the basis for the staff's projections for strong growth in final sales.

Mr. Brill replied that the projections of strength in final sales were based on consideration of the outlook in a number of sectors. These included expectations of growth in consumption as incomes increased, even if there were no significant change from recent high rates of saving, a minor rise in business fixed investment; and continued recovery in residential construction. Given the rates at which final sales had been growing recently, marked increases in growth rates in any of the various components would not be required to continue rises at the rate of $15 or $16 billion per quarter in the total over coming quarters, and when the offset of reductions in inventory investment ended, total GNP would advance rapidly.

Mr. Mitchell then asked about the basis for the projected rise in housing expenditures, which seemed to him to be inconsistent with the projections for a reduction in the rate of inflows to thrift institutions and with the assumptions regarding interest rates.

Mr. Brill commented that the interest rate levels assumed in the projection were those which the staff thought would be about the highest permissible without marked change in the pattern of recovery in residential construction. As had been noted in the presentation, further increases from present levels in intermediate- and long-term rates would likely have adverse consequences for flows to thrift institutions and for the housing market. In the staff's judgment, however, the projected rise in housing activity--which was a little slower through the fourth quarter than had been contemplated in the projection made in February--could be financed at the rate levels prevailing currently.

Mr. Maisel asked Mr. Brill to comment on his recommendation that the System eschew any attempt at present to roll back interest rates by reducing the discount rate.

Mr. Brill said that he personally would be opposed to a discount rate reduction at present because of the risk that it would convey to the market the impression that the System thought economic prospects were weak, or the impression that the System was completely confident that sufficiently strong fiscal action would be taken. In his judgment it would be a mistake to convey either impression at this time. When adequate fiscal action seemed more assured--and recent Administration statements on that subject seemed encouraging, if not completely convincing to the market--a discount rate cut might not be unreasonable.

Mr. Maisel noted that Mr. Koch had characterized the period covered by the projection as one of excessive demand for resources and asked how he defined that concept.

Mr. Koch noted that the capacity utilization rate was expected to rise to about 87 per cent by mid-1968, and the unemployment rate to return to around 3.7 per cent. While those rates of resource use were not out of line with recent experience, the staff expected them to be associated with considerable pressures on wages, costs, and prices--pressures which might increase in the period beyond that through mid-1968 covered by the projection. Relatively little slack had developed during the recent pause in economic growth, and the new uptrend would be starting from a situation of full resource utilization in many lines.

Mr. Mitchell observed that there had not been much pressure on prices in 1965 and 1966, when plant utilization rates were similar to those expected in the coming period.

Mr. Brill remarked that the rate of plant utilization was not the only relevant consideration. Unit labor costs had risen substantially during a period when industrial prices had remained relatively stable. Moreover, the autumn might be marked by enlarged wage settlements. When capacity utilization began to rise, the temptations as well as the ability to pass through rising costs in the form of higher prices would increase.

Mr. Hickman noted that, in addition to increased unemployment rates for certain groups, there had been a marked correlation recently between changes in the labor force and in employment that led him to believe that there was a good deal of hidden unemployment. The last time that situation had developed, in 1953, it had been followed by a rise in the unemployment rate. Mr. Hickman then referred to the projections for money supply, time deposits, and bank credit. He asked what they implied for the trends in bank reserves, and whether they were likely to be consistent with a noninflationary expansion.

Mr. Brill commented that the staff's model suggested more rapid increases in industrial prices, for the reasons he had noted in reply to Mr. Mitchell's question, as well as a 3 per cent rise in consumer prices from mid-1967 to mid-1968. The latter, of course, partly reflected expectations of rising food prices. As for the financial aspects of the model, the deposit projections implied growth in total reserves at an annual rate close to 10 per cent in the second half of 1967, and growth at about a 5 per cent rate in the first half of 1968. The anticipated pattern of rapid growth in reserves over the next half year, followed by a much slower rate of growth in the first half of 1968, reflected in part the expected pattern of Treasury deposits, which were projected to rise sharply over the balance of this year and then level off. These projections were thought to be consistent with the staff's model for the real economy.

Mr. Brimmer noted that in the green book[1/] residential construction expenditures were projected to increase at about a $2 billion rate in both the second and third quarters. Much of the expected increase in private final sales--including sales of furniture and other durable goods--depended on the realization of the upturn in housing that was anticipated. He asked whether the residential construction projections reported in the presentation today were lower than those shown in the green book.

Mr. Brill replied that the third-quarter projections shown in the green book were consistent with projections for the full second half of the year presented today. The expected rise in sales of consumer durable goods allowed not only for slightly higher sales of automobiles but also increases in household durables at a rate in line with the projection for housing.

Mr. Mitchell asked whether Mr. Brill thought that a 6 per cent tax increase would be adequate, or whether an increase perhaps

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

twice as large would be required. More generally, what would be the implications for the model if a 12 per cent tax increase went into effect?

Mr. Brill replied that the staff had made only one alternative projection, and that was on the assumption of no tax increase. It had not experimented with alternative possible tax increases because of uncertainties with respect to another major factor--the scale of defense expenditures. He had seen a model--not prepared by the Board's staff--in which defense spending was assumed to level off at close to current rates. According to that model, a 6 per cent tax increase would still result in a rapid fourth-quarter rise in GNP, but a return to a more moderate rate of expansion in the first and second quarters of 1968. If defense spending were assumed to be, say, $4 billion higher, the results, of course, would be quite different, and perhaps a tax increase on the order of 10 per cent would be needed.

Mr. Mitchell then remarked that the situation facing monetary policy at present seemed quite similar to that experienced last year. In his judgment a tax increase larger than 6 per cent would be required if the difficulties experienced in 1966 were not to be encountered again.

Chairman Martin commented that financial market participants seemed to have come to the same conclusion.

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

Mr. Hayes remarked that he had found the staff presentation today most interesting. The general picture portrayed of the domestic economy in the coming year was quite close to that projected by the staff at the New York Bank. Mr. Hayes then made the following statement:

> We seem to be approaching another period when the choice of appropriate monetary policy becomes increasingly complex and difficult. A sideways movement of the economy in the last few months has called for our maintaining a policy of steady moderate ease. Now, however, there are more and more signs that a vigorous upturn is probably not many months away. The worst of the inventory drag seems to be over and consumer spending seems to be regaining vigor. Both the debt position and the asset position of consumers have clearly strengthened substantially. A renewed expansion of plant and equipment outlays is indicated for the second half, following the dip of early 1967. At the same time defense spending is continuing its strong uptrend. Costs continue to be under pressure and the major price indexes have turned upward once more. While this turn has been of very modest proportions so far, a resumption of inflationary pressures from the demand side is not unlikely later in the year, in the context of very strong cost-push factors.
>
> Higher defense expenditures have caused upward revisions in budget deficit estimates and our own measures of prospective fiscal stimulus. While we may hope for cuts in presently budgeted nondefense spending, it seems quite clear that a tax increase of more than 6 per cent will be urgently needed, especially in view of the likelihood that the Vietnam fighting may accelerate further. It is

heartening to note the evident determination of the Administration to press for a sizable tax increase within the next few months, with the amount presumably depending on a clearer view of budgetary prospects, as well as the development of the economy during this period. As I told our directors last week, I hope that American businessmen will be wise enough to give this tax proposal their strong support, in contrast with the rather equivocal position they took on taxes in early 1966.

As has been true for some time now, the balance of payments statistics make very discouraging reading. Unless there is a very considerable improvement in June, the seasonally adjusted second-quarter deficit is likely to be higher than that of the first quarter. Apart from special transactions having some of the characteristics of "window dressing", we appear to be faced with an underlying liquidity deficit at an annual rate of about $4 billion. This remains true in spite of considerable recent improvement in our trade surplus. Lower short-term interest costs in the U.S. have found some reflection in increased use of American bank credit abroad, especially in Japan. Although head office balances from American bank branches abroad have tended to stabilize after the decline of earlier months, 1967 will undoubtedly show a sizable official settlements deficit, and our gold stock is therefore threatened much more seriously than it was last year. With the Middle East crisis contributing importantly to a decidedly nervous atmosphere in exchange markets, the dollar has been under growing pressure. Under these conditions, prompt removal of the 25 per cent gold cover requirement would certainly be a constructive step, but there is also an urgent need for further efforts to reduce our payments deficit even while the Vietnam fighting is continuing.

As usual, recent statistics on bank credit are not easy to interpret. The rate of bank credit growth in May was well below the rate prevailing over the first quarter. However, the large June tax payments may produce some acceleration of bank credit growth this month, and July also looks relatively strong. Looking at the first half of 1967 as a whole, we cannot escape the conclusion that bank credit growth has been rapid. Moreover, the explanation for this does not appear to lie in increased financial intermediation since other credit flows--notably borrowing in the securities market, as well as flows of funds into savings institutions--have continued at high or in some instances record levels. While bank credit growth has been moderate over the past twelve months, after taking account of last autumn's declines, the 1967 rate of increase is clearly steeper than we would like to see continued over a prolonged period. There seem to be differing views of bankers as to the strength of credit demands in the coming months. But if it were not for the fact that the huge volume of bond issues is providing substantial funds for bank loan repayments, we would probably be seeing a sharp net increase in bank loans outstanding.

As I have indicated, our policy of ease has been reflected in a rapid growth of credit and of liquidity in general. Thus, the precipitate rise in interest rates over recent weeks can hardly be construed as evidence of a firmer policy. Rather, it is a reflection of very heavy credit demand especially in the longer maturities, expectations of a major pickup in business activity later this year, and worries over the size of prospective Treasury borrowing. The Congressional mixup over the debt ceiling has not been helpful to market psychology.

It seems apparent to me that we are getting closer to the time when a policy change in the direction of greater firmness will be desirable. The principal question, however, in my mind concerns appropriate timing. Here I think we must give careful attention to three factors: (1) the state of market psychology, (2) even-keel considerations, and (3) possible effect of a policy change on fiscal action. Obviously, the bond market has been in a nervous state, particularly last week, and a noticeable change in policy on our part might well accentuate this. This could make the Treasury's heavy financing problem all the more difficult. With respect to even-keel considerations as such, the timing of the Treasury's operations is still uncertain, but it looks as if an announcement of new cash financing could come by early July. Finally, I have no clear view myself as to whether the Administration's willingness to press for a much needed tax increase would be lessened if we were to make a modest and fairly unobtrusive, but nonetheless visible, move toward firmer open market policy.

We are faced with the prospect of frequent Treasury offerings during the rest of 1967, so that there may be few opportunities for policy changes. Of course additional bill financing might not require the same degree of solicitousness on our part as would longer-term financing. I think that we should continue the recent policy with respect to the purchase of coupon issues, although here again Treasury financing operations may restrict our purchases from time to time to areas not closely contiguous in maturity, thereby further limiting the quantity of purchases that can be made.

While I await with interest the views of the other Committee members, I think I lean toward maintaining our present policy for the time being. I would regard this, however, as merely a postponement of a problem with which we shall probably have to deal in the rather near future.

I have already indicated that I would favor continued purchases of coupon issues in line with recent policy. This I think is well understood and should not be repeated in each of our directives. I therefore suggest the deletion of the phrase "while continuing to utilize operations in coupon issues in supplying part of reserve needs" in the draft directive. At the same time, I would also like to see the Robertson proviso clause reintroduced, on a two-way basis, as a means of renewing the focus on bank credit flows and enabling us to get an early start at moderating excessive credit growth if it should begin to develop. To this end I suggest the addition after the word "Committee" of the phrase "but operations shall be modified, in so far as Treasury financing permits, in the light of bank credit developments."

Mr. Ellis remarked that the New England economy showed no notable change in conditions since the Committee's last meeting, which was meaningful in the sense that contraction had halted but expansion had not commenced. In view of the repeated observations that banks had been building liquidity, he had been somewhat interested in reviewing the regular tabulation of the proportion of required reserves that was being borrowed by the District's eight largest banks in the form of negotiable CD's, net Federal funds purchases, and borrowings from the Federal Reserve, in comparison with similar figures for the eight largest New York City banks. Considering averages for the first five months of 1967, he found that the eight New York banks had a ratio of 169 per cent, almost unchanged from the last half of 1966 and down 10 per cent from the first half of 1966. Two of the First District's eight largest banks had ratios higher than 169 per cent; five had ratios higher than in the last half of 1966; and four had ratios higher than the first half of 1966. Obviously, dependence on CD's had become a way of life for large First District banks even more so than for their New York City counterparts.

Turning to monetary policy, Mr. Ellis said that the dominant impression he received in studying economic developments in the nation was that continuing strength--continuing sharp expansion in final demands, both private and public--was providing the quite unusual spectacle of an inventory adjustment of substantial proportions without actual declines in inventories so far, although a decline was projected for the third quarter of 1967. A related impression was that, given the lack of growth in inventories, business loan growth at an annual rate of 9.4 per cent in the past three months (or 11.2 per cent in the past twelve months) was certainly adequate. In fact, bank credit expansion had to be considered a major stimulative factor, both retrospectively and prospectively.

Looking ahead, Mr. Ellis continued, with $15 billion U.S. financing projected for the second half, even keel considerations at times of financings will be of dominant importance. It was important to ask how much the Committee could submit to even keel considerations.

The staff presentation this morning was quite helpful to the Committee in focusing on the outlook, Mr. Ellis said. He did not reach the same conclusions as the staff had, however, because he did not start with the same assumptions. In particular, there were four assumptions underlying the projections that he thought were highly questionable. First was the assumption of a 6 per cent surcharge on income taxes, effective July 1 for corporations and October 1 for individuals. Frankly, he thought Congressional reaction to the Administration's recent proposals regarding the debt ceiling was not encouraging for tax increase prospects. Moreover, he suspected that the resumption of economic expansion had not yet been sufficiently registered in the available statistics for Congress to be persuaded that it was occurring.

Secondly, Mr. Ellis remarked, he questioned the assumption regarding a deceleration in the growth of defense expenditures. The news stories he read talked more about escalation in Vietnam than about deescalation. Third, he doubted that business fixed investment would be as low as assumed. In his judgment, the impact of the restoration of the 7 per cent investment tax credit was yet to come, and would begin to show this fall. Finally, it was assumed that monetary restraint would stop short of the point at which it would jeopardize the recovery in the housing industry. One might ask what monetary restraint would affect if not housing.

Mr. Ellis commented that even given those four assumptions--including the best of two worlds in connection with taxes and defense spending--the expected rate of credit expansion matched that of the first half of 1966. That fact gave the staff some concern, in view of the lag in the effects of monetary policy, but they concluded that the cost of acting on convictions was serious in light of the possible consequences for thrift institutions and the housing industry. He was concerned about the cost of not acting on convictions, especially since he expected conditions to be more inflationary than the staff did. In that connection, he noted that in a paper prepared for a meeting tomorrow Professor Shaw of

Stanford University said, "There are costs in even-keeling. . . . They include . . . excessive rates of change in the reserve base and money supply."

Mr. Ellis referred to Mr. Brill's comment that all policy makers had learned the lessons of 1966. One such lesson was that policy worked with a lag. Accordingly, he concluded that there were hazards in the projected growth in July of nonborrowed reserves at an annual rate of 11 to 14 per cent. He would urge, as he had on other occasions, that such a growth rate be viewed not as the desired objective of monetary policy but as a price to be paid if Treasury financing of the contemplated magnitude was to be accommondated in lieu of a tax increase.

If the Committee had to accept the hazards of a "wait-and-see" policy, Mr. Ellis concluded, the draft directive seemed to be generally appropriate. However, he would endorse Mr. Hayes' suggestion that the reference to purchases of coupon issues be omitted, on the grounds that such purchases were now a regular instrument.

Mr. Irons said that conditions in the Eleventh District were moderately expansive on balance, with minor increases or decreases scattered through various sectors. Although contruction employment was weak the over-all employment rate remained quite low. The industrial production index showed scattered franctional declines, and there was much uncertainty with respect to possible developments in crude petroleum and oil refining. Construction activity was up about 5 per cent for the year to date compared with the same period in 1966, but residential construction in the District was not showing the kind of strength that was evident nationally. Department store sales were up a little from a year ago and sales of automobiles also were higher. Agricultural conditions, on the whole, were much improved. There had been moisture in large parts of the District, livestock conditions were good, and livestock prices were up a little from a year ago. For all farm products, prices were about 10 per cent below a year ago, and in the first six months of the year cash farm receipts were off about 25 per cent.

In the financial area, Mr. Irons continued, conditions at District banks had shown little change recently. As he had reported at the previous meeting, the large banks were more liquid than a year ago but less liquid than they would like to be. They were expecting increased loan demand, and they felt that they had more leeway now than a year ago to accommodate such demand; their loan-deposit ratios had dropped from around 72 - 74 per cent then to perhaps 66 - 68 per cent at the present time. Investments of banks were up slightly, mostly in non-Government securities; with time and savings deposits continuing to rise and current loan demands still moderate, they were putting their funds into non-Governments.

Commercial and industrial loans had declined recently, and loans to brokers and dealers were off by fairly sizable amounts for this time of year. With the exception of a few small country banks with seasonal needs, District banks were not borrowing from the Federal Reserve Bank. District banks were net purchasers of Federal funds, averaging $475 million net purchases over the past period. In general, the larger banks appeared to be keeping in balance by borrowing in the Federal funds market rather than from the Reserve Bank.

As to policy, it seemed to Mr. Irons that the national picture as described in the presentation this morning pointed toward the need for somewhat less ease, other things equal. In his judgment, the picture of the domestic economy that had been projected was one of real strength, and the balance of payments situation was not improving. The situation with respect to the Federal deficit was discouraging, and as yet no one could say what kind of fiscal action would be taken or when. He agreed with Mr. Ellis that getting a tax increase enacted was not likely to prove easy.

During the past month, Mr. Irons remarked, the Desk had created an atmosphere of relative ease. While there had been wide fluctuations during the period, they averaged out reasonably well, with free reserves in a $250 - $300 million range, the Federal funds rate below 4 per cent, the bill rate around 3.50 per cent, and member bank borrowing negligible. Were it not for the Treasury financing situation--which might lead to a need for a more-or-less continuous even keel--he personally would favor drifting away from the recent degree of ease in the market. In any case, the Committee might well begin to think about moving a bit toward restraint soon, in view of the outlook. The present unfavorable conditions in markets for long-term corporate and Treasury securities seemed to him to be due to a combination of uncertainties, relating to the size of the Treasury deficit, Vietnam, and recollections of the summer of 1966.

In the coming period, Mr. Irons noted, the System would be putting funds into the market, and that would provide an opportunity to make further purchases of coupon issues. Such purchases might temper the weakness in the long-term market. However, they would simply represent the use of one operating technique rather than another, and he agreed with Mr. Hayes that there was no need to continue referring to them in the directive. Having indicated its intentions once, the Committee should not let the reference to coupon operations become frozen in the directive.

Although he favored introducing a degree of restraint when possible, Mr. Irons said, during the interval until the next meeting he would follow roughly the same policy as recently, maintaining the money market conditions that had prevailed during the past four weeks. He thought the Committee should watch the situation closely, anticipating that sooner or later it would become necessary to exercise some restraint in view of the expansionary factors in the whole economic picture. He had not favored including a proviso clause in the directive from its inception, and would not restore it at this time.

Mr. Swan commented that recent conditions in the Twelfth District showed no marked deviations from the national situation. Employment in manufacturing and construction in the Pacific Coast States declined again in May. Total employment changed little, however, and the unemployment rate dropped one-tenth of one per cent. In the four weeks through June 7 weekly reporting banks in the Twelfth District experienced a rather sizable increase in total loans and investments. There was very little change in loans, a decline in holdings of Government securities, and a marked increase in holdings of municipals. The major banks in the District continued to be net buyers of Federal funds and borrowers from corporations under repurchase agreements. At the same time they continued to lend in rather sizable amounts to securities dealers, as they had been doing for some time.

As to policy, Mr. Swan agreed with the comments already expressed. He would, somewhat reluctantly, accept the necessity of maintaining about the same conditions in the money market in the weeks ahead, in view of the Treasury financing and the conditions existing in the capital market. Although he saw no need for more restraint in the immediate situation, given the kinds of pressures visualized in the staff presentation this morning he agreed that the Committee should be thinking about such a move at some point.

With respect to the second paragraph of the draft directive, Mr. Swan agreed with both of Mr. Hayes' suggestions--to delete the reference to operations in coupon issues and to restore the proviso clause. He had some question about the opening sentence of the first paragraph of the draft, which said that ". . . economic expansion is resuming." While he had no quarrel with the projections of resumed growth, it seemed to him that at the moment the surge was more an expectation than an actuality. Accordingly, he would suggest changing the phrase to read ". . . economic activity is rising modestly." Finally, the concluding clause of the second sentence referred to "growth in final demands." For the sake of parallelism, he would change the subject of the first clause of that sentence from "output" to "growth in output."

Mr. Galusha reported that agricultural conditions in the Ninth District had turned for the better and, for the moment at least, that had checked the spread of anti-Administration feeling among farm operators. Rains throughout the District in recent weeks had substantially improved both moisture conditions and the prospects of a record year in crop production. The June 1 crop report, for example, estimated that wheat production this year would be 23 per cent ahead of 1966 output. That estimate, it should be noted, was put together before the rains relieved most of the potential danger areas in South Dakota. If crop prices could manage to hold close to their 1966 levels, and if the May upturn in livestock prices was maintained as he expected it to be, then cash farm receipts should approach last year's remarkable volume.

During the first four months of the year, Mr. Galusha noted, unemployment in the District remained quite stable at a level slightly below the average fourth-quarter rate. Contributing to that stability was the performance of manufacturing employment, which held up quite well, in large part because of expanded operations in firms and plants producing defense products. In May, preliminary estimates indicated a modest rise in the unemployment rate to break the pattern of stability. Despite the rise, unemployment remained low, in relation to both previous District rates and the current national rate.

Total credit at District country banks was up very strongly in May with loans accounting for most of the increase, Mr. Galusha continued. That was the pattern that had prevailed since the turn of the year. In fact, from the end of December to the end of May the increase in total credit at country banks was more than double the advance of any comparable period, and the gain in loans was roughly 50 per cent higher than any preceding rise. One of the factors accounting for that extraordinary loan expansion came from the farm sector. The Minneapolis Bank's April 1st survey of District agricultural banks revealed that farm demand for long-term real estate credit was noticeably higher than last year and was expected to remain relatively heavy over the next several months.

Mr. Galusha commented that total credit at weekly reporting member banks, after moving rapidly ahead in April, declined in May on both an absolute and seasonally adjusted basis (month-end to month-end). The decline was far heavier in the loan area, particularly business loans, than in the investment category. That performance, however, might give a misleading picture of loan demand at District city banks. He recently had talked with bankers from the three largest institutions in the Twin Cities. They were quite emphatic in reporting that business loan demand in virtually every category remained stronger than previously anticipated and was expected to swell much more than seasonally in coming months. Their loan-deposit ratios had declined modestly and their purchases of Federal funds had dropped toward more normal levels, but any upsurge in loan demand accompanied by higher market rates of interest would quickly leave them little room for maneuvering. Just how much faith should be placed in their firmly held expectation of an upturn in loan demand was difficult to say. As noted in the supplement to the green book, bankers (and he could add others to the list) did not have an unsullied forecasting record.

Mr. Galusha then said that he would submit the following statement with respect to the national picture for the record:

> We start with the assumption that the staff's forecast of GNP increases of $10 billion in the second quarter and $14 billion in the third quarter is correct. The correctness of those forecasts depends in part on whether there is a pick-up in residential construction. While cross-currents in this area are difficult to read or interpret, the advance in commitments at savings and loan associations and the May jump in housing starts argues well for the housing upturn expected by the staff and built into its forecast.
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> If the forecasts are correct, as we assume, then what happens in the fiscal area is of utmost relevance to monetary policy deliberations. There is general uncertainty as to whether the Administration will propose a tax increase and as to the timing of the increase.
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> It seems to me we have two alternatives: (1) If the tax increase is not expected until January or later, it might be better now to let both long- and short-term interest rates stay at approximately current levels without making any special effort--either through coupon purchases or by providing ample reserves--to put downward pressure on rates. Why? In order to provide some moderation--which indeed may hit in the residential construction area--during the third and fourth quarters. (2) If a tax increase seems likely before January (or to put it another and better way, if the effect on planning and on expectations of a proposed tax increase has an impact before January), then it might be well to pursue the type of policy to which the staff discreetly hints in the blue book in the period immediately ahead. Evidently, a large volume of reserves will be needed simply to make the expected Treasury financing a success. And the Manager will have

> to be given a great deal of latitude. The staff states that nonborrowed reserves in July will have to increase at an annual rate of 11 to 14 per cent to accommodate a $4 billion Treasury cash financing and bring about (or likely bring about) some moderation in "upward interest rate pressures in intermediate- and long-term credit markets."
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> Since I agree with the last approach I would instruct the Manager to conduct open market operations so as to keep intermediate- and longer-term rates at approximately current levels unless nonborrowed reserves are increasing at an annual rate greater than 11 to 14 per cent. If it would take a faster rate of reserve growth, I would certainly hesitate to give it.
>
> In addition, the Manager should be instructed to supply a large portion of reserves, if at all possible, through coupon purchases.

Mr. Galusha added that for the period between now and the next meeting the Committee would seem to have no alternative other than attempting to maintain an even keel. He was particularly mindful of the desirability of doing nothing to relieve pressure on the Administration to seek fiscal action.

Mr. Scanlon reported that economic activity in the Seventh District remained generally stable at a level which was fairly satisfactory for the present, but additional slack was developing as capacity continued to expand. Objective evidence of a renewed expansion of activity remained elusive but confidence continued strong that such a revival would occur. And as people were pressed for reasons for that confidence such views commonly were offered as an expression of "faith" in the ultimate impact of stimulative monetary and fiscal policies.

Demand for capital equipment varied from product to product and firm to firm, Mr. Scanlon commented. Truck sales did not appear to have shared in the recent improvement in auto sales, and heavy truck output had been reduced sharply as order backlogs had been worked off. On the other hand, sales of farm machinery and equipment by the District's three major producers were reported to have recovered from the slump earlier this year and to be about even with last year's high level. Steel firms could offer no concrete evidence of a revival in activity. Auto firms still were not ordering steel up to the rate of consumption.

Auto sales in May and early June showed definite improvement, Mr. Scanlon continued. Apparently, 1967 model output schedules were "frozen" in April at a level that would have been raised if sales had been forecast accurately. As a result, the model clean-up was expected to be easily accomplished. Demand for appliances, television, and furniture apparently remained sluggish.

On the banking front, Mr. Scanlon said, managements at many of the large District banks reported that they still expected stronger business loan demand in the months ahead, and a number reported demand stronger in mid-May than three months earlier. One bank stated that it was making some industrial term loans because "institutional lenders have not returned to the market." Term loans accounted for about a quarter of net business loan repayments in May. The District's money market banks were again purchasing Federal funds in substantial amounts, but they had not acquired any significant amount of CD money in the past three weeks. Rates offered on 3 to 6 month CD's had edged up slightly. Some of the major banks still had loan-deposit ratios nearly as high or higher than the peak levels reached last year.

As to policy, Mr. Scanlon favored a posture of no change at this time. He shared Mr. Hayes' views with respect to the deletion of the phrase on coupon issues in the directive. He thought the Committee currently was without adequate statistics to strongly support the first sentence in the draft directive and, therefore, he would prefer the wording suggested by Mr. Swan.

Mr. Clay commented that the anticipated Treasury Department fund raising program would be an important consideration in shaping monetary policy for most of the interval until the next meeting of the Committee. That made a strong case for using the maintenance of prevailing money market conditions as the basic guideline for open market operations during the period.

Even apart from Treasury financing, Mr. Clay remarked, it would be appropriate to aim toward the maintenance of essentially current money market conditions. There probably would be some difference, however, in the developments in the monetary aggregates under those circumstances. The expected growth in member bank credit as outlined in the blue book, for example, was higher than one might wish and higher than would be necessary except for facilitating the Treasury financing and maintaining essentially the prevailing money market conditions under those circumstances.

Generally speaking, Mr. Clay said, the current and prospective developments in the national economy continued in the pattern discussed at the last meeting of the Committee. Some phases of the private sector were still undergoing readjustment, but on the whole the private sector appeared to be headed for substantial advancement later in the year. The public sector remained a key factor in the expected growth in the economy as the year unfolded, particularly as a result of the economic impact of spending for national defense. All factors considered, price inflation could be expected to become a problem from developing pressures on both the demand and the cost sides of the market. Accordingly, it should be the Committee's desire to pursue a monetary policy which was only moderately expansive and distinctly less expansive than in the early months of this year.

In conducting open market operations, Mr. Clay concluded, the Manager should include coupon issues among those he stood ready to purchase in the course of supplying reserve needs, the type of Treasury offering permitting. The draft economic policy directive was satisfactory to him. He had no strong feeling on the question of including the reference to operations in coupon issues.

Mr. Wayne reported that trends in business activity in the Fifth District had been mixed in recent weeks, with the balance perhaps slightly on the down side. In April nonagricultural employment fell by the largest amount since last September, and responses from the Richmond Bank's business panel indicated that it eased slightly further in May. Hours worked in manufacturing dropped in April and fell a little further in May. Building permits, seasonally adjusted, were down slightly in May, and reports indicated that construction activity had been significantly lower in recent weeks. On the general outlook for the near future, the survey panel expected a slight improvement.

As the national economy approached midyear, Mr. Wayne said, the statistics presently available gave no tangible evidence of the upturn which had long been expected. The continuing large Federal deficit and the substantial increases in bank credit of the past five months had undoubtedly moderated the extensive adjustments which the economy had experienced, and had helped to avert any large and cumulative declines. They might also have laid the basis for a resumption of vigorous growth, but thus far the statistics gave no indication of such a change. For the current and coming quarters, he was somewhat less optimistic than the tone of the green book which also was reflected in the model for the year ahead presented this morning by the staff.

Basically, Mr. Wayne believed that the Committee should maintain its present posture. He would include the proviso clause in the directive as suggested by Mr. Hayes, and he favored continued activity in coupon issues. Obviously, he shared Mr. Swan's question about the appropriateness of the opening sentence of the first paragraph of the draft directive. The statement included in the draft was not supported and therefore was unwarranted.

Mr. Mitchell remarked that the economic outlook was particularly difficult to assess at the moment; it always was hard to determine how much strength was being generated in a turn-around period such as the present. Psychological factors were unusually significant and difficult to deal with at this time. He was impressed by the staff's presentation today, but not entirely convinced by it. Therefore, he was not prepared--as the staff evidently was not prepared--to proceed on the assumption that the projection would be realized.

Unlike others, Mr. Mitchell observed, he thought the Administration could not avoid pressing for a tax increase in light of the prospective Federal deficit, the rises in price indexes, and the prospect of very tight money if fiscal action were not taken. Accordingly, he believed that a tax increase should be expected in the near future. If he believed otherwise he would not want to wait much longer before changing monetary policy; indeed, he would want to act today.

Mr. Mitchell said he came out in favor of no change in policy at this time, in the hope that before the Committee's next meeting the Administration would have moved on the matter of a tax increase. He favored including a reference to operations in coupon issues in the directive. Such operations were one way of adding to the Committee's effectiveness, and the decision on their scope was one for the Committee, rather than the Manager, to make. He would be willing to have the Desk run off bills and replace them with coupon issues. He favored coupon operations not so much to strengthen longer-term markets but to increase the supply of short-term issues. Such operations also were desirable in light of the balance of payments situation. He thought the draft directive was satisfactory.

Mr. Maisel noted that he agreed with a good deal of what Mr. Mitchell had just said. The staff presentation today had made clear that the critical problems in the coming period would be related not so much to questions of aggregates as to questions of mix. Various distortions existed, of both inflationary and deflationary types, depending on the part of the economy under consideration. The problems in the real economy related both to large military demands and to civilian sectors that were shifting gears in various ways. The projection made clear that with respect to both the real economy and credit flows it was necessary to give careful consideration to composition as well as to totals.

Mr. Maisel said he agreed that a tax increase was likely. However, he did not expect the Administration to move before the next meeting, partly because the chances of enactment would be increased if consideration was delayed until after expected decisions in the military area were taken.

With respect to the directive, Mr. Maisel said he would favor retaining the reference to operations in coupon issues. The Committee's policy with respect to coupon operations had shifted from time to time in the past, and if he were in the Manager's position he certainly would want to have the Committee exercise responsibility for decisions in that area. In that connection, the System's portfolio now included a smaller proportion of coupon issues than it had at times in the past, and in his judgment increasing the holdings of such issues would represent good portfolio management.

Mr. Maisel said he would not favor including a proviso clause in the directive at this time because the expected rate of bank credit expansion was so highly dependent on the type and timing of Treasury financing. The projection given in the blue book was based on certain assumptions regarding Treasury financing. It could not be accurately described as an "expectation" since it would not be meaningful if the Treasury took decisions other than those assumed. In short, he favored a second paragraph for the directive along the lines of the staff draft.

Mr. Brimmer remarked--in connection with the comments made today on the probable timing of fiscal policy action--that he understood that the Director of the Bureau of the Budget was expected to appear before a Congressional committee in late July or early August to give a mid-year assessment of the Federal budgetary situation. It seemed unlikely that the Administration would send any new communication on taxes to Congress before the Budget Director had testified. Accordingly, he did not agree with Mr. Mitchell that action on taxes could be expected before the Open Market Committee's next meeting.

With respect to policy, Mr. Brimmer said that, as a minimum, he would favor maintaining the prevailing money market conditions and not taking any overt action in the direction of less restraint. At the same time, he would hope that the Committee would keep a close watch on developments during the next few months. It was particularly important to avoid an erosion of the revival in the construction industry. For that reason he favored operating as much as possible in the long-term market, and he would retain the reference to coupon operations in the directive.

Mr. Brimmer said he had given some thought to possible orders of magnitude of coupon operations in the coming period. He gathered that the Desk would be supplying reserves on a net basis in the neighborhood of $1/2 billion. While he was not prepared to suggest that any particular percentage of that figure be supplied through purchases of coupon issues, the figure did imply that there was room for a sizable volume of such purchases.

Mr. Brimmer saw no advantage to including a proviso clause in the directive at this time. He agreed with Mr. Swan's criticism of the first sentence of the draft directive. In place of the language Mr. Swan proposed, however, he would suggest saying ". . . the prospect of renewed economic expansion later in the year appears to have strengthened."

Mr. Sherrill said he shared what was obviously the majority view today that the Committee should continue its present policy of fostering monetary and credit conditions conducive to renewed expansion. He agreed with the view expressed that the resumption of economic expansion was more a matter of expectation than actuality; at this point most indicators had not yet turned up to any significant degree. Financial markets also seemed to be under the influence of expectations, and the difficulties in the market were likely to be increased if the Committee took any action that would reinforce current expectations.

The housing industry might well be a critical sector in the second half of the year, Mr. Sherrill continued. Long-term interest rates already were close to the point at which they would begin to diminish the rate of housing activity. In his judgment that consideration should be taken into account in open market operations, with purchases of coupon issues employed to the extent possible. If the Committee agreed on that point, he believed that the reference to operations in coupon issues should be retained in the directive since it would be a significant element in the policy decision. He would not favor including a proviso clause for this period.

Mr. Hickman said that his interpretation of the latest statistics was less sanguine than that in the green book and in the staff's presentation today, although there did appear to have been some slight improvement in residential construction and in auto sales from earlier depressed lows. While there was a widespread consensus among business observers that there would be a surge in the economy later this year, both the magnitude and the timing of the recovery were still very much in question. The Committee's main job at the moment was to do what it could to make sure that the fourth-quarter levels implied in the green book were actually attained. Given the unknowns about fiscal policy--the rate of increase in defense spending and whether and when there would be a tax increase--monetary policy had little alternative but to continue to be moderately accommodative. The private sector was still vulnerable to premature actions toward restraint; caution had to be exercised so as not to abort recovery.

Contrary to the tone of the green book, Mr. Hickman continued, his staff believed that the inventory adjustment was far from over. Despite the lower rate of buildup, manufacturers' sales had fallen below expectations and no net progress appeared to have been made in reducing excess stocks. Manufacturing had been the principal trouble spot up to now, but the Reserve Bank's contacts in retail trade suggested that a new phase of inventory adjustment in general merchandising might just be beginning.

Although the slower pace of economic activity had scarcely affected the rate of total unemployment up to now, Mr. Hickman remarked, the Committee should not overlook hidden unemployment reflected in the decline in the labor force, as well as reductions in the average workweek and overtime hours. Moreover, the rate of unemployment for sensitive key groups--in particular, manufacturing workers, nonfarm laborers, and nonwhites--had risen significantly in recent months.

Mr. Hickman reported that increased doubts about the current strength of the economy had been stressed at the latest quarterly meeting of Fourth District economists held at the Cleveland Reserve Bank on June 9. Concern was expressed as to whether the inventory adjustment would be completed in time to permit the hoped-for fourth-quarter spurt in gross national product; or if, instead, a protracted inventory adjustment would converge with weakness in capital spending that might develop as a delayed reaction to the squeeze on profits. Skepticism mixed with hope was an outstanding feature of the discussion at that meeting.

In the present environment of short-term weakness and anticipated longer-term strength, Mr. Hickman saw no reason why there should be a change in monetary policy. In his opinion, however, "no change" meant a return to the posture that prevailed before the Committee's last meeting. If he read the figures correctly, the System seemed recently to have been obsessed with a free reserve target, and to have allowed the money market to tighten and aggregate reserve measures to lag. For example, during the period from May 10 through June 7, the free reserve figures, which averaged $271 million as first published, had an average weekly deviation of only $12 million. Over the March-June period there had been virtually no growth in total reserves and a markedly reduced rate of growth in nonborrowed reserves and required reserves. All of that gave him the uncomfortable feeling that the System might not have been providing sufficient reserves to the banking system to encourage the type of revitalization in economic activity that everyone sought. Finally, he would like to recommend again that coupon issues be purchased, when feasible, even if that occasionally meant selling shorts to purchase longs. Two weeks ago the Committee stopped operations in the long-term market just when they finally seemed to be having a perceptible influence, and the market slumped back to earlier lows.

Therefore, Mr. Hickman said, until the next meeting he would like to see the Committee aim for the targets he had recommended at the last meeting; specifically, average long-term growth in the aggregate reserve measures and in bank credit at a 6 per cent to 8 per cent annual rate, with free reserves fluctuating in whatever range resulted from achieving those targets. Of course, the Treasury financing would cause considerable movement upward and downward in the growth rates of bank reserves and bank credit over the next few weeks, and for that reason he thought the Committee should look beyond the weekly figures to the long-run projections.

Mr. Hickman preferred Mr. Swan's wording for the first sentence of the directive, and he would include the reference to coupon issues in the second paragraph.

Mr. Bopp said that, along with everyone else, he had been looking for signs of pick-up in the economy, but in spite of improvements since the first quarter he still saw business as rather sluggish. Nevertheless, he felt the economy was basically strong.

The pace of adjustment in the Third District mirrored that nationally, Mr. Bopp remarked. Large Philadelphia banks reported only modest loan activity, and that was particularly true of business loan extensions. Final demand remained sluggish and signs of slack prevailed. There were, however, fewer signs of further weakening than four weeks ago and continuing evidence that rates of decline were slowing.

As he looked ahead, Mr. Bopp had no doubt that economic activity would accelerate. The questions were by how much and when. His analysis of the forces likely to be at work during the rest of this year placed him with those who looked for relatively moderate expansion. Pressures of demand on the economy's resources--as measured, for example, by the operating rate in manufacturing--were not likely to be so great as to pose serious problems of inflation. But, on the cost side, the pattern of wage settlements could result in some upward pressure on prices as businessmen attempted to maintain profit rates.

Financial markets could require special attention, Mr. Bopp remarked. They clearly were anticipating tighter conditions in the fall. They were gambling that new Government demands for funds combined with continuing private demands could not be accommodated without higher rates and tighter availability. But whether that assumption was correct should rest on developments in the real sector of the economy. Unless prices were tending to rise the Committee should foster conditions that would enable private demands for funds plus the enlarged Federal Government demands to be accommodated.

Mr. Bopp favored a wait-and-see approach. The inflationary risks of the present degree of ease were still less than the risks of cutting off the orderly adjustments now occurring. Thus, he believed that a continuation of the policy of the past four weeks was called for. Open market purchases should be concentrated in coupon issues to the extent possible.

Mr. Patterson said that he could see little in the recent past behavior of the economy in both the Sixth District and the nation to explain the improvement in sentiment that he found to have taken place. The Directors of the head office and branches of the Atlanta Bank were almost universally optimistic about future prospects, and that apparently reflected the general sentiment throughout the country. The adjustment process the economy had been experiencing might be setting the stage for a later revival, but the improved sentiment was based on expectations, not realizations.

Mr. Patterson noted that a revival of residential construction activity had been counted on to bolster the District's economy. Construction contracts were still trending downward, and activity as measured by construction employment was still slipping. Nevertheless, expectations of future improvement were prevalent. A large majority of the mortgage bankers in the District, responding to the survey of mortgage bankers the Atlanta Reserve Bank was now conducting, foresaw housing production in 1967 as being equal or better than in 1966. Forty-six per cent expected it to be above 1966. About 60 per cent of the respondents representing 18 of the 28 market areas in the District reported that housing demand was improving.

Mr. Patterson reported that high interest rates or discounts and a shortage of mortgage money were the most common reasons given for the slow recovery in housing. However, the differing conditions reported for the various market areas throughout the District suggested that other factors must be of some importance in holding back a revival. Cost and several nonfinancial factors were frequently cited by the respondents. There was no doubt that an easing of long-term rates would improve the residential construction outlook in the Sixth District. Nevertheless, it seemed questionable that reducing the cost and increasing the availability of mortgage funds would automatically create a strong revival in residential construction.

Turning to the national scene, Mr. Patterson said that current economic conditions did not warrant a more restrictive policy. A case for further ease, on the other hand, seemed to rest on whether it was needed to facilitate an orderly adjustment and whether it was required to correct an undesirable structure of interest rates. As to the former, although the System's policy had undoubtedly contributed to a more orderly adjustment, that adjustment was closely related to nonmonetary forces and further ease would contribute little, if anything, to facilitate the process. As to the latter, the present structure of rates was heavily influenced by expectational forces over which the System had no control.

A minor move toward ease would be ineffectual in reducing long-term rates, whereas a policy designed to bring long-term rates down significantly would require such a massive injection of reserves as to be undesirable. Under the circumstances, a steady policy position seemed to be in order. Considering the expected Treasury financing, such a policy seemed to be especially appropriate. He would favor the directive as drafted.

Mr. Lewis commented that economic conditions in the St. Louis District so far this year had approximated those in the rest of the nation. Manufacturing employment had eased in the latest month. Other employment had declined slightly since February. At the District banks, loans had risen more rapidly than at banks in the rest of the nation and deposits at about the same rate. Spending, as indicated by bank debits, had continued to expand since December. Sentiment and plans of businessmen seemed to be very definitely on the expansive side.

Nationally, Mr. Lewis continued, the hesitation in spending and production seemed to have continued another month. Yet production remained high and the general trend of prices was still upward. There appeared to be basic strength in economic prospects for coming months.

Both fiscal and monetary actions had been expansionary, Mr. Lewis said. The high employment budget deficit was estimated at an $8 billion annual rate in the first half of 1967. That was $11 billion more stimulative than in the first half of last year and $17 billion greater than the 1961-65 average. Federal Reserve credit, member bank reserves, commercial bank credit, and money had all risen over the past three months and over the past six months at rates substantially above their longer-run trends.

Since most of the effect of fiscal and monetary actions came after a lag, Mr. Lewis remarked, it appeared to him that this autumn the problem was more likely to be one of excessive total demand than one of inadequate demand. Recent monetary and fiscal actions might be expected to stimulate spending, and most forecasts--including the one in the green book--pointed to a marked increase in total spending by the third quarter.

It seemed to Mr. Lewis that expansion of bank reserves, bank credit, and money in the near future should not be at such high rates as those projected. That restraint would give a more appropriate mix of fiscal and monetary policy, considering the expansionary fiscal stance of the Government over the next few months. Some stimulus to capital and money market interest rates might initially result from that monetary policy, but excessive tightness in those markets might thereby be avoided later in the year.

Accordingly, Mr. Lewis would prefer that immediate policy should provide for some firming of the money market in the next month, tempered, if necessary, by consideration for the Treasury financing.

Mr. Robertson then made the following statement:

> Considering the long agenda we have today, I will be brief in my policy comments this morning. Let me start off by saying that the current level of long-term rates is higher than I regard as desirable over the longer run. But, given the kind of economic resurgence ahead sketched for us by the staff, I do not think we can risk unilateral action now to make monetary policy aggressively easier in order to try to relax such credit market tensions. Current long-term bond market pressures are very much the product of a continuing very large fiscal deficit and the economic and financial consequences that are expected to flow from it. Such pressures can best be handled by an appropriate fiscal program (including a tax increase) that deals forthrightly with the root cause of so many of our present problems.
>
> As soon as such a program is brought forward--and the sooner the better, from my point of view--we can well have a significant improvement in financial markets and a corresponding tendency for at least some interest rates to decline. I think we should allow such rate declines to develop and support them fully by maintaining ample reserve availability and comfortable tone in the day-to-day money market.
>
> But I would not like to see us try to precipitate rate declines in advance of such fiscal decisions by any kind of monetary maneuvering. In particular, I continue to regret our involvement in the longer-term bond markets. However well-intentioned our purchases of coupon issues are, the evidence is inescapable that they have made the long-Government market increasingly dependent upon Federal Reserve support. Since we entered that market in May, dealers report that other net buyers of Government bonds have been almost nonexistent. Bond prices have rallied only so long as we were buying, and have dropped back down dishearteningly as soon as there was a pause in our takings. It is tempting to argue that what is needed is simply a more strenuous effort on our part, but I am afraid that in this arena we can easily talk ourselves into the same fix as Bre'r Rabbit with Tar Baby. I hope

we can work ourselves out of the difficulty with a minimum of lasting damage to the market mechanism, but frankly each succeeding buying episode makes me a little less optimistic.

There is one more longer-range policy consideration on which I would like to comment: that concerns the use of the proviso clause at this time in the directive. Uncertainties associated with the timing and amount of the upcoming Treasury financing would appear to argue against any addition of a proviso clause to today's directive. But as soon as those uncertainties are behind us, I hope we will reinstate the proviso clause as a regular part of our instructions to the Manager. It has proven itself to be a valuable tool for adapting System operations to unforeseen strengths or weaknesses in credit demands. The record shows that it helped to make some of our policy changes during the last year more timely. On the other hand, it has not led to any "false starts" in operations or unresolvable conflicts in instructions. We may, from time to time, find ourselves engaged in lively arguments as to the precise measures or magnitudes in which it should be expressed, but these debates can be meaningful analytically, and they should not be allowed to obscure the fundamental advantages which the proviso clause brings to the formulation and execution of monetary policy. So, next meeting, or the meeting after that, you can expect to hear me arguing vigorously that we should return the proviso clause to full-time duty in the directive.

As for today's directive decision, I would be generally in favor of the directive as drafted by the staff, but without the final clause on operations in coupon issues. If, however, the consensus still favors its inclusion at least one more time, I will go along without dissent in the interest of permitting an orderly--and I hope early--working out of this phase of our operations. In addition, in order to make it clear that it is uncertainty as to the timing and amount of the Treasury financing that makes it appropriate to gear our operations solely to conditions in the money market during this period, I suggest that the words "the timing and quantity of which are still uncertain" be inserted after "Treasury financing activity" in the second paragraph. That seems to me to be the real reason why we are gearing our policy solely to money market conditions.

Mr. Robertson added that he would much prefer either Mr. Swan's or Mr. Brimmer's version of the first sentence of the directive to that in the staff's draft.

Chairman Martin remarked that he agreed with most of the comments in the discussion of policy today and had nothing to add.

The meeting then recessed and reconvened at 2:00 p.m. with the same attendance.

Chairman Martin proposed that the Committee proceed to consider various suggestions that had been made in the course of the go-around for modifying the language of the draft directive, starting with the suggestions of Messrs. Swan and Brimmer concerning the opening sentence of the first paragraph.

Following some discussion, Mr. Hayes proposed that phrases like those suggested by both Mr. Swan and Mr. Brimmer be employed, in a sentence reading as follows: "The economic and financial developments reviewed at this meeting suggest that economic activity is rising modestly, and that prospects for economic expansion later in the year have strengthened."

There was general agreement with Mr. Hayes' proposal.

The Committee then agreed to add the phrase, "the timing and quantity of which are still uncertain" after the words "Treasury financing activity" in the second paragraph, as proposed by Mr. Robertson.

Chairman Martin then noted that while divergent views had been expressed on the desirability of referring again to operations in coupon issues in the second paragraph of the directive, it appeared that a majority of members favored including the reference.

Mr. Hayes commented that he recognized the position of the majority on that question. In listening to the discussion, however, he had become concerned about two matters. First, while he shared the view that the residential construction sector was important and that it was desirable for the recovery in that sector to proceed, he did not think the Committee should be over-solicitous about housing. It was possible to conceive of circumstances which would call for some slowing of growth in residential construction. More generally, in the absence of fiscal policy action he did not think that monetary policy should be expected to carry the burden of insuring that housing maintained its share of the GNP.

Secondly, Mr. Hayes continued, he thought there were basic differences of view among Committee members regarding the extent to which operations in coupon issues should be used, which were perhaps best typified by the positions taken today by Mr. Robertson and Mr. Brimmer. His (Mr. Hayes') personal view was closer to the middle ground; he favored use of coupon operations, but he recognized the risks they entailed and wanted them to be kept marginal.

Mr. Brimmer referred to Mr. Hayes' first point and commented that in advocating coupon operations he (Mr. Brimmer) was not simply concerned with residential construction as a sector requiring special attention. Rather, he viewed the housing sector as the only major component of private spending in which there was a real prospect of an autonomous increase later this year. Because output rates in other areas, such as household durable goods, were so closely related to the pace of residential construction, for the sake of assuring recovery in the economy generally he thought it was important to try to avoid aborting the housing recovery. As to the second point, he had commented in his earlier remarks on the possible scale of reserve-supplying operations in the coming period in order to help the Committee focus on the scope for operations in coupon issues. While he had not suggested that the full $1/2 billion of reserves likely to be added on a net basis be supplied through purchases of coupon issues, that figure did offer some perspective on the matter.

Mr. Maisel said that he had not been thinking of the housing sector when he had advocated coupon operations in his earlier comments. His point was that if the composition of the System's portfolio of Government securities in, say, 1961 or 1962 was used as a standard, the present portfolio should include about $2 billion more of securities maturing in over five years than it did. At a time like the present when the market demand for bills was strong and there was little interest in long-term issues, he thought it would be appropriate for the System to help meet the market's needs by shifting the System's portfolio composition in the direction of that of earlier years.

Mr. Holmes remarked that the composition of the System's portfolio probably would more closely resemble that of the earlier period Mr. Maisel had mentioned if in recent years the Treasury had been able to issue new securities with maturities over five years. In his judgment, Desk operations in coupon issues had to be undertaken cautiously to minimize the risks they involved.

Chairman Martin then noted that he would not favor including a proviso clause in the directive at this time, and he thought that was the view of the majority today. He suggested that the Committee vote on a directive with a second paragraph as given in the staff draft, except for the amendment proposed by Mr. Robertson to which agreement had already been expressed.

> 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 suggest that economic activity is rising modestly, and that prospects for economic expansion later in the year have strengthened. Output is still being retarded by adjustments of excessive inventories, but growth in final demands continues strong, reflecting substantial further increases in Government expenditures and also some strengthening of consumer buying. Prices of farm products have turned up recently, but average

prices of industrial commodities have remained stable. The pace of bank credit expansion has increased in recent weeks, but is still well below the rapid rate of earlier in the year. Most long-term interest rates have tended to rise further under the influence of heavy securities market financing, and most short-term yields have also increased. The balance of payments deficit has remained substantial despite some improvement in the foreign trade surplus. In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions, including bank credit growth, conducive to renewed economic expansion, while recognizing the need for progress toward reasonable equilibrium in the country's balance of payments.

To implement this policy, while taking account of expected Treasury financing activity, the timing and quantity of which are still uncertain, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the same conditions in the money market as have prevailed since the preceding meeting of the Committee, while continuing to utilize operations in coupon issues in supplying part of reserve needs.

Chairman Martin then suggested that the Committee continue its discussion of the procedures to be followed in compliance with the "Freedom of Information Act," which would become effective July 4, 1967. He asked Mr. Robertson to comment on the status of the request for an executive order that would exempt information on foreign currency operations from the provisions of the Act.

Mr. Robertson said that in accordance with the discussion at the preceding meeting of the Committee, a request for an executive order covering foreign currency operations of both the Treasury and the Federal Reserve had been developed in cooperation with the Treasury and, after review by the Department of Justice, it had been forwarded to the Bureau of the Budget yesterday. Copies of the letter to the Budget Bureau, together with attachments consisting of a draft executive order and a supporting memorandum, had been distributed to the Committee.[1] As yet there had been no indication as to whether the request would be approved.

Chairman Martin asked Mr. Hackley what the consequences would be if the requested executive order was not issued.

Mr. Hackley replied that in his judgment most of the material regarding foreign currency operations which it had been suggested should not be disclosed probably fell within one or more of the exemptions listed in the Act. Thus, the Committee probably could rely on those exemptions if the executive order was not issued, although it should be recognized that such a course might result in litigation. Another alternative was suggested by the State Department's request for an amendment to the 1953 executive order regarding classification of "defense information" to broaden the definition of that term. If that order was amended as requested, the question would arise as to whether the Treasury and the System should follow the same approach, and ask that the order be amended to cover their foreign currency operations. As he had indicated at the preceding meeting, however, operating under that executive order would involve considerable administrative burden and red tape.

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

For the time being he recommended that the Committee rely on the statutory exemptions if an executive order of the type it had requested jointly with the Treasury was not issued. The Committee could consider the matter further, in light of developments, at its next meeting.

Mr. Hackley then noted that at its previous meeting the Committee had approved in principle, subject to any necessary technical or editorial changes, a draft of new Committee rules regarding the availability of information. A revised draft of the rules had been distributed with his memorandum of June 15, 1967.[1/] As discussed in the memorandum, there were two main modifications from the earlier draft. First, at the recommendation of the staff of the Federal Reserve Bank of New York, a passage in subsection (c) of section 271.4, indicating that requests for records available at the New York Bank could be addressed to the Secretary of that Bank, had been deleted. However, the rules would continue to state that the Secretary of the Board may advise persons seeking certain records that they were available at a Federal Reserve Bank.

Secondly, Mr. Hackley continued, subsection (a) of section 271.5 of the earlier draft had listed, as examples of records that would not be published or made available for inspection until after a specified time lag, not only the Committee's current

1/ A copy of this memorandum and attachment has been placed in the Committee's files economic policy directive but also the continuing authority directive for domestic operations, the authorization for System foreign currency operations, the foreign currency directive, and any amendments to such documents. The revised draft specifically mentioned only the current economic policy directive. The principal reason for that change was to permit nondisclosure of certain amendments to the other instruments, where the amendments were of unusually sensitive nature, for a period longer than that--such as 60 or 90 days--to be prescribed in the rules in connection with the current economic policy directive. A secondary reason for the change was to allow the Committee greater flexibility in the other direction--so that it could decide, for example, to publish the continuing authority directive or the foreign currency authorization or directive promptly after their readoption at the annual organization meeting, without delaying publication for the specified period.

Mr. Hackley then observed that in a meeting of members of the Legal Division with the representatives of other banking agencies last Friday two points had been raised that suggested the desirability of additional modifications in the draft rules. One modification would be to include a statement to the effect that records that were exempt from disclosure under the statute would nevertheless be made available to the public to the fullest extent possible in the Committee's judgment. The Department of Justice felt strongly that such a statement should be included, and he shared their view. Specifically, he would recommend adding the following sentence to subsection (a) of section 271.4: "Records falling within the exemptions from disclosure set forth in section 552(b) of Title 5 of the United States Code and in section 271.6 of this Part may nevertheless be made available in accordance with this section to the fullest extent consistent, in the Committee's judgment, with the effective performance of the Committee's statutory responsibilities and with the avoidance of injury to a public or private interest intended to be protected by such exemptions."

The other modification proposed, Mr. Hackley said, was to include a specific statement of the charges that would be made for locating and copying records. The Department of Justice agreed that charges of $5 per hour for the time spent in locating records, and 10 cents per page for copying, were reasonable. Accordingly, in subsection (c) of section 271.4 he would propose deleting the nonspecific statement regarding charges contained in the draft dated June 15, and replacing it with the following specific statement: ". . . and such person shall pay a fee in an amount based upon $5 per hour for the time required to locate such records and prepare them for inspection plus 10 cents per standard page for any copying thereof."

If the Committee was agreeable to those modifications, Mr. Hackley continued, the only remaining question regarding the rules of information would concern the number of days for which publication of the current economic policy directive would be deferred, to be specified in subsection (a) of section 271.5. He would recommend, once that question was resolved, that the Committee take final action to adopt the revised rules regarding the availability of information, effective July 4, 1967. He would also recommend certain technical changes, involving no questions of substance, in the Committee's rules of organization and procedure, along the lines of those described in his memorandum of May 16, 1967. Finally, he would suggest that the revisions in these rules be sent to the Federal Register some time next week, perhaps June 28 or 29, to insure that they would be published no later than July 4.

In answer to Mr. Mitchell's question as to whether charges for locating and copying records were mandatory, Mr. Hackley said that the law required that any fees charged be specified, and the Justice Department thought that fees might be useful to minimize frivolous requests for information. The charges could, however, be waived.

Mr. Brimmer referred to Mr. Hackley's suggestion that the rules state that exempt information would be made available to the greatest extent possible, and asked whether the Secretary of the Committee would be expected to refer all requests for exempt information to the Committee.

Mr. Hackley expressed the view that Committee approval of the release of exempt information would be desirable.

Chairman Martin then noted that some members of the Committee, including himself, had indicated in earlier discussions that they favored a 60-day time lag in publishing the current economic policy directive, while others had expressed a preference for a 90-day lag. Since there were differences of view, he would now suggest that a 90-day lag be employed for the time being. The lag could always be reduced to 60 days at some later time, if that should prove desirable.

There was general agreement with the Chairman's suggestion.

By unanimous vote, the Federal Open Market Committee's rules regarding the availability of information were revised, effective July 4, 1967, to read as follows:

RULES REGARDING AVAILABILITY OF INFORMATION

SECTION 271.1--BASIS AND SCOPE

This Part is issued by the Federal Open Market Committee (the "Committee") pursuant to the requirement of section 552 of Title 5 of the United States Code that every agency shall publish in the Federal Register for the guidance of the public descriptions of the established places at which, the officers from whom, and the methods whereby, the public may obtain information, make submittals or requests, or obtain decisions.

SECTION 271.2--DEFINITIONS

(a) "Information of the Committee". - For purposes of this Part, the term "information of the Committee" means all information coming into the possession of the Committee or of any member thereof or of any officer, employee, or agent of the Committee, the Board of Governors of the Federal Reserve System, or any Federal Reserve Bank, in the performance of duties for, or pursuant to the direction of, the Committee.

(b) "Records of the Committee". - For purposes of this Part, the term "records of the Committee" means rules, statements, opinions, orders, memoranda, letters, reports, accounts, and other papers containing information of the Committee that constitute a part of the Committee's official files.

SECTION 271.3--PUBLISHED INFORMATION

(a) Federal Register. - To the extent required by sections 552 and 553 of the U.S. Code, and subject to the provisions of sections 271.5 and 271.6 of this Part, the Committee publishes in the Federal Register, in addition to this Part,

(1) a description of its organization;

(2) statements of the general course and method by which its functions are channeled and determined;

(3) rules of procedure;

(4) substantive rules of general applicability, and statements of general policy and interpretations of general applicability formulated and adopted by the Committee;

(5) every amendment, revision, or repeal of the foregoing; and

(6) general notices of proposed rule making.

(b) Policy record. - In accordance with section 10 of the Federal Reserve Act (12 U.S.C. 247a), each annual report made to Congress by the Board of Governors of the Federal Reserve System includes a complete record of the actions taken by the Committee during the preceding year upon all matters of policy relating to open market operations, showing the votes taken and the reasons underlying such actions.

(c) Other published information. - From time to time, other information relating to open market operations of the Federal Reserve Banks is published in the Federal Reserve Bulletin, issued monthly by the Board of Governors of the Federal Reserve System, in such Board's annual report to Congress, and in announcements and statements released to the press. Copies of issues of the Bulletin and of annual reports of the Board may be obtained upon request.

SECTION 271.4--RECORDS AVAILABLE TO THE PUBLIC ON REQUEST

(a) Records available. - Records of the Committee are made available to any person, upon request, for inspection or copying in accordance with the provisions of this section and subject to the limitations stated in sections 271.5 and 271.6 of this Part. Records falling within the exemptions from disclosure set forth in section 552(b) of Title 5 of the United States Code and in section 271.6 of this Part may nevertheless be made available in accordance with this section to the fullest extent consistent, in the Committee's judgment, with the effective performance of the Committee's statutory responsibilities and with the avoidance of injury to a public or private interest intended to be protected by such exemptions.

(b) Place and time. - In general, the records of the Committee are held in the custody of the Board of Governors of the Federal Reserve System, but certain of such records, or copies thereof, are held in the custody of one or more of the Federal Reserve Banks. Any such records subject to this section will be made available for inspection or copying during regular business hours at the offices of the Board of Governors of the Federal Reserve System in the Federal Reserve Building, 20th and Constitution Avenue, Washington, D. C., 20551, or, in certain instances as provided in paragraph (c) of this section, at the offices of one or more designated Federal Reserve Banks.

(c) Obtaining access to records. - Any person requesting access to records of the Committee shall submit such request in writing to the Secretary of the Board of Governors of the Federal Reserve System. In any case in which the records requested, or copies thereof, are available at a Federal Reserve Bank, the Secretary of the Board may so advise the person requesting access to the records. Every request for access to records of the Committee shall state the full name and address of the person requesting them and shall describe such records in a manner reasonably sufficient to permit their identification without undue difficulty; and such person shall pay a fee in an amount based upon $5 per hour for the time required to locate such records and prepare them for inspection plus 10 cents per standard page for any copying thereof.

SECTION 271.5--DEFERMENT OF AVAILABILITY OF CERTAIN INFORMATION

(a) Deferred availability of information. - In some instances, certain types of information of the Committee are not published in the Federal Register or made available for public inspection or copying until after such period of time as the Committee may determine to be reasonably necessary to avoid the effects described in paragraph (b) of this section or as may otherwise be necessary to prevent impairment of the effective discharge of the Committee's statutory responsibilities. For example, the Committee's current economic policy directive adopted at each meeting of the Committee is published in the Federal Register approximately 90 days after the date of its adoption; and no information in the records of the Committee relating to the adoption of any such directive is made available for public inspection or copying before it is published in the Federal Register.

(b) Reasons for deferment of availability. - Publication of, or access to, certain information of the Committee may be deferred because earlier disclosure of such information would

(1) interfere with the orderly execution of policies adopted by the Committee in the performance of its statutory functions;

(2) permit speculators and others to gain unfair profits or to obtain unfair advantages by speculative trading in securities, foreign exchange, or otherwise;

(3) result in unnecessary or unwarranted disturbances in the securities market;

(4) make open market operations more costly;

(5) interfere with the orderly execution of the objectives or policies of other Government agencies concerned with domestic or foreign economic or fiscal matters; or

(6) interfere with, or impair the effectiveness of, financial transactions with foreign banks, bankers, or countries that may influence the flow of gold and of dollar balances to or from foreign countries.

SECTION 271.6--INFORMATION NOT DISCLOSED

Except as may be authorized by the Committee, information of the Committee that is not available to the public through other sources will not be published or made available for inspection, examination, or copying by any person if such information

(1) is exempted from disclosure by statute or executive order;

(2) relates solely to internal personnel rules or practices or other internal practices of the Committee;

(3) relates to trade secrets or commercial or financial information obtained from any person and privileged or confidential;

(4) is contained in inter-agency or intra-agency memoranda or letters, including records of deliberations and discussions at meetings of the Committee and reports

and documents filed by members or staff of the Committee that would not be routinely available to a private party in litigation with the Committee;

(5) is contained in personnel, medical, or similar files (including financial files) the disclosure of which would constitute a clearly unwarranted invasion of personal privacy; or

(6) is contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of any agency responsible for the regulation or supervision of financial institutions.

Except as provided by or pursuant to this Part, no person shall disclose, or permit the disclosure of, anyinformation of the Committee to any person, whether by giving out or furnishing such information or copy thereof, by allowing any person to inspect, examine, or reproduce such information or copy thereof, or by any other means, whether the information is located at the offices of the Board of Governors of the Federal Reserve System, any Federal Reserve Bank, or elsewhere, unless such disclosure is required in the performance of duties for, or pursuant to the direction of, the Committee. Any person who may be denied access to records of the Committee may, within 5 days thereafter, file with the Committee a written request for review of such action.

SECTION 271.7--SUBPOENAS

(a) Advice by person served. - If any person, whether or not an officer or employee of the Committee, of the Board of Governors of the Federal Reserve System, or of a Federal Reserve Bank, has information of the Committee that may not be disclosed by reason of sections 271.5 or 271.6 of this Part and in connection therewith is served with a subpoena, order, or other process requiring his personal attendance as a witness or the production of documents or information upon any proceeding, he should promptly inform the Secretary of the Committee of such service and of all relevant facts, including the documents and information requested and any facts that may be of assistance in determining whether such documents or information should be made available; and he should take action at the appropriate time to inform the court or tribunal that issued the process, and the attorney for the party at whose instance the process was issued, if known, of the substance of this Part.

(b) Appearance by person served. - Except as disclosure of the relevant information is authorized pursuant to this Part, any person who has information of the Committee and is required to respond to a subpoena or other legal process shall attend at the time and place therein mentioned and decline to disclose such information or give any testimony with respect thereto, basing his refusal upon this Part. If, notwithstanding, the court or other body orders the disclosure of such information, or the giving of such testimony, the person having such information of the Committee shall continue to decline to disclose such information and shall promptly report the facts to the Committee for such action as the Committee may deem appropriate.

By unanimous vote, section 1 of the Federal Open Market Committee's rules of organization was revised, effective July 4, 1967. The amended rules of organization read as follows:

RULES OF ORGANIZATION

SECTION 1--BASIS AND SCOPE

These rules are issued by the Federal Open Market Committee (the "Committee") pursuant to the requirement of section 552 of Title 5 of the United States Code that every agency shall publish in the Federal Register a description of its central and field organization.

SECTION 2--COMPOSITION AND MEETINGS OF COMMITTEE

(a) Members. - The Federal Open Market Committee consists of the members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve Banks who are Presidents or First Vice Presidents of such banks. The representatives of the Federal Reserve Banks, and an alternate for each representative, are elected in accordance with section 12A of the Federal Reserve Act for terms of one year commencing on March 1 of each year.

(b) Chairman and Vice Chairman. - At its first meeting on or after March 1 of each year, the Committee selects a Chairman and a Vice Chairman from among its membership.

(c) Meetings. - The Committee meets at Washington, D. C., on call by the Chairman of the Board of Governors of the Federal Reserve System or at the request of three members of the Committee, at least four times each year and oftener if deemed necessary.

SECTION 3--PERSONNEL

(a) Official Staff. - The official staff of the Federal Open Market Committee includes its Secretary and Assistant Secretaries, General Counsel and Assistant General Counsel, and Economist and Associate Economists, who perform the duties indicated by their titles. These staff members are selected from among the officers and employees of the Board of Governors of the Federal Reserve System and the Federal Reserve Banks. In addition, one of the Federal Reserve Banks is selected by the Committee to execute transactions for the System Open Market Account; and the Committee selects a Manager of the System Open Market Account and a Special Manager for foreign currency operations for such Account, both of whom shall be satisfactory to such Federal Reserve Bank.

(b) Others. - The services of other officers and employees of the Board of Governors of the Federal Reserve System and Federal Reserve Banks are made available and are utilized by the Committee as required.

By unanimous vote, sections 272.1 and 272.3 of the Federal Open Market Committee's rules of procedure were revised, and section 272.5 repealed, effective July 4, 1967. The amended rules of procedure read as follows:

RULES OF PROCEDURE

SECTION 272.1--BASIS AND SCOPE

This part is issued by the Federal Open Market Committee (the "Committee") pursuant to the requirement of section 552 of Title 5 of the United States Code that every agency shall publish in the Federal Register its rules of procedure.

SECTION 272.2--COMMITTEE ACTION

The function of the Committee is the direction and regulation of open market operations which are conducted by the Federal Reserve Banks. This involves the determination of the policies which are to be pursued with respect to open market operations by the Federal Reserve Banks with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country, together with consideration and action upon incidental matters relating to the manner in which such operations are to be conducted. The discharge of the Committee's responsibilities requires the continuous gathering of information and study of changing financial, economic, and credit conditions and other pertinent considerations by the members of the Committee and its personnel. These activities are closely interrelated with other activities of the Board of Governors of the Federal Reserve System and the Federal Reserve Banks and all relevant information and views developed by these organizations are available to the Committee. With this background, action is taken by the Committee upon its own initiative at periodic meetings held at least four times each year and oftener if deemed necessary. Attendance at Committee meetings is restricted to members of the Committee and its official staff, including the Manager of the System Open Market Account and the Special Manager for foreign currency operations for such Account, the Presidents of Federal Reserve Banks who are not at the time members of the Committee, and such other advisers as the Committee may invite from time to time. The Committee acts through the adoption and transmittal of directives and regulations to the Federal Reserve Banks. Operations in the System Open Market Account are conducted pursuant to directives issued by the Committee.

SECTION 272.3--NOTICE AND PUBLIC PROCEDURE

There ordinarily will be no published notice of proposed action by the Committee or public procedure thereon, as described in section 553 of Title 5 of the United States Code, because such notice and procedure are impracticable, unnecessary, or contrary to the public interest.

SECTION 272.4--EFFECTIVE DATE

> Committee action ordinarily will be made effective on the date the action is taken because the nature of the subject matter and the action taken is such that the public interest and the proper discharge of the Committee's responsibilities so require.

In response to a question by Chairman Martin, Mr. Hackley said that he thought it would be desirable, at about the time the Committee's new rules were transmitted to the Federal Register, to release them to the press, along with the record of policy actions of the Committee for the meetings held in 1967 through April 4. Those policy record entries might also be filed with the Federal Register, with a notice that they were available on request to the Board of Governors.

Mr. Brimmer remarked that, looking beyond the initial publication of materials under the new rules, he would assume that about 90 days after each meeting the policy record entry for that meeting, including the current economic policy directive adopted then, would be released to the press; that the directive and policy record entry would be transmitted to the Federal Register at about the same time, in the expectation that the former would be published in the Register and the latter probably held on file, with a notice published that it was available on request; and that the policy record entry would be republished in the next issue of the Federal Reserve Bulletin for which republication was feasible.

Mr. Hackley indicated that he had had in mind a procedure similar to that described by Mr. Brimmer. He added that the Committee's policy record for the full calendar year would, of course, also be published in the Board's Annual Report for that year, in accordance with the Federal Reserve Act. In that connection, he noted that the full year's policy record for 1966 and other recent years had been made available to Congress and the press in considerably less than 90 days following the last meeting of the year. Since that had been the practice in the past, he saw no reason why it could not be continued in the future, if such a course was desired, even though a time lag of about 90 days was employed for the release of the policy record entries for all meetings other than the final one of the year.

After discussion, it was agreed that the procedures suggested by Mr. Hackley for the initial release of materials next week, and those described by Mr. Brimmer for the subsequent release of materials, would be followed.

> By unanimous vote, the Committee approved the release to the press and to other interested persons of the entries prepared for the record of policy actions of the Committee approximately 90 days after the meetings at which the policy actions were taken, and the release of the entries prepared for the meetings held in 1967 through April 4 at about the time the Committee's rules, as revised today, were transmitted to the Federal Register.

Chairman Martin then asked Mr. Hackley about the procedure he would recommend for release of the Committee's foreign currency authorization and directive and its continuing authority directive.

Mr. Hackley said he thought it was generally agreed that often little or no lag would be considered necessary in publishing, say, an amendment to the continuing authority directive. At times, however, it might be necessary to withhold information concerning an amendment to one of the three instruments in question for more than 90 days. Accordingly, it did not appear desirable for the Committee to bind itself to any specific time lag for those instruments. As he had indicated earlier, the example employed in the new rules in connection with the statement that publication of certain materials would be deferred was confined to the current economic policy directive; that gave the Committee flexibility with respect to the timing of release of information concerning actions affecting the other instruments.

Chairman Martin then noted that the Committee had received a staff memorandum dated May 17, 1967 regarding the proposed availability of records relating to domestic open market operations at the Federal Reserve Bank of New York under the Freedom of Information Act, and a memorandum from Mr. Coombs dated June 19, 1967 concerning information on System foreign operations and the Freedom of Information Act.[1/] He invited Mr. Hayes to comment.

1/ Copies of the memoranda referred to have been placed in the files of the Committee.

Mr. Hayes noted that an attachment to the memorandum of May 17 presented a list of documents containing information of the Committee that were held at the Federal Reserve Bank of New York which the staff recommended be made available, with the time lags indicated, to any person on request. He suggested that the Committee approve those recommendations of the staff. He also suggested that a small staff committee, composed of the Secretary, the General Counsel, and the Manager, be appointed and be given specific authority to deal with any relatively minor problems that might arise in connection with the release of information, on the understanding that major questions would be referred back to the Committee. He believed that a variety of minor questions were likely to arise.

Mr. Hackley noted in that connection that the Board of Governors had delegated to the Board's Secretary the authority to make available information of the Board. While he had expressed the view earlier today that it would be desirable for the Committee to approve the disclosure of exempt material, in the interest of efficiency it probably would be desirable for the Committee to delegate to the staff committee the authority to deal with questions that were not of major importance.

In response to a question by Mr. Brimmer, Mr. Holmes said that the list attached to the May 17 memorandum included all documents originating at the New York Bank relating to domestic open market operations that were considered nonexempt, as well as certain documents that were believed to be exempt but which the staff thought might be made available to the public. It seemed likely that requests would be received for other documents that were similar to those on the list, and it was thought that the staff committee could dispose of such requests. If documents materially different from those on the list were asked for, the staff committee would refer the matter to the Open Market Committee.

Chairman Martin said he thought it would be desirable to appoint such a staff committee, and he would suggest that the Secretary of the Board be included along with the members Mr. Hayes had proposed. The Chairman then asked whether there was any objection to the staff's making available on request the documents listed in the attachment to the memorandum of May 17, or to the appointment of staff committee consisting of Messrs. Hackley, Holland, Holmes, and Sherman with authority to make decisions of the type described regarding requests for documents not specifically listed in the attachment.

No objections were voiced to either proposal.

By unanimous vote, the Committee approved the release to any person on request of certain documents held at the Federal Reserve Bank of New York containing information of the Committee, described in the list dated May 17, 1967, prepared by the staff, with time lags as indicated therein.

By unanimous vote, the Committee authorized a staff committee consisting of the Committee's General Counsel, the Manager of the System Open Market Account, the Secretary of the Committee, and the Secretary of the Board of Governors, to authorize release to any person on request documents held at the Federal Reserve Bank of New York containing information of the Committee of types similar to those for which the Committee had authorized release, with such time lags as were considered appropriate by the staff committee in light of the time lags the Committee had authorized for other documents.

In response to the Chairman's request for a statement of his recommendations for dealing with information on foreign operations, Mr. Coombs said they could be summarized simply by saying he recommended that no new records pertaining to System foreign exchange operations be made available to the public beyond those that were now available.

Mr. Maisel asked whether that recommendation by Mr. Coombs also applied to another item on today's agenda, concerning Committee policy with respect to publication of information on drawings under the System swap network and on other System foreign currency operations.

Mr. Coombs replied that his present recommendation was confined to the questions arising under the Freedom of Information Act, which he thought were separable from those that would arise in connection with the other agenda item mentioned.

Mr. Holland noted that there had been a staff memorandum dated April 28, 1967, on the subject to which Mr. Maisel had referred. That subject had been included on the agenda for several meetings of the Committee, but had been carried over on each occasion.

Chairman Martin commented that the item in question did not appear urgent, and he would propose that it be held over once more so that Messrs. Daane and Solomon could participate in the discussion.

Mr. Hackley referred to Mr. Coombs' recommendation that no new information on foreign exchange operations be made available, and said that he assumed Mr. Coombs meant that no new information of types that fell within the statutory exemptions be made available. It would be necessary, of course, to make available any information that was not exempt under the provisions of the Freedom of Information Act.

Mr. Holland commented that Committee staff members had held meetings to review the pertinent New York Bank records with staff members of the New York Bank concerned with both domestic and foreign exchange operations. With respect to documents in the domestic area, as Mr. Holmes had indicated the conclusions were that some were nonexempt, and that some that were thought likely to be exempt could nevertheless be made available. In the area of foreign exchange operations, on the other hand, it had been concluded that practically all documents were exempt; and with respect to none of these, other than those currently available, was it concluded that it would be desirable to make them available.

Mr. Coombs added that if a person requesting additional information relating to foreign currency operations challenged the staff's statement that the material desired was exempt from disclosure under the Act, he would propose to refer the matter to the Committee for disposition.

Mr. Brimmer suggested that it might be helpful if a systematic presentation was given to the press of all of the types of information on System foreign currency operations that were now made available. It was likely that many members of the press were not familiar with the complete array of information currently published.

Chairman Martin suggested that the staff keep that possibility in mind. It was clear that a considerable amount of staff work would be required in this area, and that the Committee would have to feel its way in making the appropriate decisions. The object, of course, should be full compliance with the Freedom of Information Act.

Chairman Martin asked whether there was any objection to the course Mr. Coombs recommended with respect to information on System foreign exchange operations, and none was heard.

The Chairman then noted that a memorandum had been distributed from Messrs. Holland and Sherman dated June 9, 1967, and entitled "Release of 1961 FOMC minutes."1/ He asked Mr. Holland to comment.

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

Mr. Holland remarked that he and Mr. Sherman recommended the transfer of the original copy of the Committee's 1961 minutes, in their entirety, to the National Archives at this time, on the same basis as the minutes for prior years had been transferred in 1964. While such action was not required by the Freedom of Information Act, it would be consistent with its spirit. An earlier staff memorandum had suggested that both the 1961 and 1962 minutes might be considered for release, with such deletions of sensitive material as seemed necessary. However, as a result of a new staff review of the 1961 minutes, and after consultation with the Treasury concerning a letter originating in that Department that was cited in full in the minutes, the staff had concluded that the full minute record for 1961 could be made public. A similar review of the minutes for 1962 raised questions as to whether certain material therein should be considered for deletion before those minutes were released, and therefore the staff did not recommend their transfer to the National Archives at this time.

Chairman Martin said he would favor the release now of the Committee's 1961 minutes.

Mr. Brimmer suggested that the Committee might agree today to a program under which the minutes for an additional calendar year would be transferred to the Archives annually, with a lag of about five years. It probably would be helpful to historians and others if such a program could be announced.

Chairman Martin said that Mr. Brimmer's suggestion had merit, but in view of the possible need for deleting some material from the 1962 minutes he thought the Committee was not ready to make that type of decision at this time. In that connection it would be desirable for all of the members to review the 1962 minutes soon, and at some point the Committee should hold a full discussion of procedures for releasing minutes covering periods after 1961. He personally had re-read the 1961 minutes recently, and he agreed with the staff that they could be released in full at this time. His general inclination was to transfer minutes to the Archives on as rapid a schedule as practicable, but the possible problems should be given careful thought.

Mr. Wayne said he also was inclined to release minutes as rapidly as possible. He favored an ad hoc approach to the matter, however, partly because at its previous meeting the Committee had approved a modification of the form of its minutes.

Mr. Hayes commented that a thorough study of the potential problems in releasing the minutes for 1962 would be desirable since it was in that year that the System had launched its program of operations in the foreign currency area.

> By unanimous vote, the Committee approved the transfer of the original copy of the minutes for the Committee meetings held in the calendar year 1961 to the National Archives, on the same basis as the minutes for prior years had been transferred in 1964.

Chairman Martin then noted that a memorandum by Mr. Maisel, entitled "Time for FOMC meetings," had been distributed to the Committee on June 7, 1967.[1] The Chairman invited Mr. Maisel to comment.

Mr. Maisel noted that the Committee had been pressed for time today and in other recent meetings. His suggestion was that it explore the possibility of holding a longer meeting--perhaps beginning on Monday afternoon and continuing on Tuesday morning--about once a quarter. The additional time available at such meetings would be devoted to more thorough discussion of staff projections, such as those presented today, and consideration of their implications for policy. If such meetings were held quarterly, the Committee could afford to devote less time at the intervening meetings to current reporting of economic events.

Mr. Wayne remarked that he and his staff had given a great deal of thought to Mr. Maisel's proposal and had concluded that it had much merit. He noted that from time to time certain significant information first became available to Reserve Bank people in the course of staff comments at Committee meetings, and he would not want to lose the opportunities to obtain such information at meetings. In general, however, he would favor holding longer meetings periodically,

1/ A copy of this memorandum, which had originally been addressed to the Board of Governors on May 29, 1967, has been placed in the Committee's files.

and having the volume of material that came before the Committee at intervening meetings reduced.

Mr. Hickman said that his staff had reviewed the proposal and had prepared a memorandum which he would submit for the record.[1/] He would note now, however, that the Committee would be aided in reaching a consensus regarding staff projections of GNP if the projections were available to the Reserve Bank Presidents perhaps a week before the meeting, so that the Bank staffs could have more time to study them. If that were to be done, the Committee might ask its staff to consider the best times to hold the longer meetings. One possibility might be to schedule them for the third Tuesday in the months of January, April, July, and October. In any case, Mr. Maisel's proposal appealed to him and he would like to have it explored further.

In response to the Chairman's request for comment, Mr. Brill remarked that as a general principle the staff would appreciate having more time than it had under present procedures to discuss the implications of its projections with the Committee and to respond to questions concerning them. However, it might be unwise to adopt any fixed schedule for the longer meetings because the times at which they were likely to prove most helpful often would depend on economic

1/ The document referred to is appended to this memorandum as Attachment B.

developments. He would also note that a relatively long lead time--about four to six weeks--was required to develop a GNP model and to explore its financial implications. In sum, the staff thought that the general procedure Mr. Maisel had proposed would be helpful to the Committee, but it would suggest flexibility with respect to the frequency and timing of the longer meetings.

Mr. Hayes said that Mr. Maisel's proposal that somewhat longer Committee meetings be held from time to time, perhaps once a quarter, struck him as being worth exploring. The gist of the proposal stemmed from a belief, which he (Mr. Hayes) shared, that the Committee probably did not spend enough time in looking at somewhat longer-run projections of the economy, and their implications for credit policy. It seemed to him that it would be essential that such projections be circulated to the Committee at least a week before the special meeting, as Mr. Hickman had suggested. The alternative, of a staff presentation of a new set of projections at the meeting, would be very time-consuming and would leave little time for careful consideration by the Committee. Advance circulation would permit each member to review the projections and to formulate questions and perhaps alternative views. With such an arrangement, the actual staff presentation at the meeting could be kept to a minimum, with increased time for active debate over the questions raised by the projections. He would also suggest that an economist from each Reserve Bank be asked to participate in the discussions of the projections. If the proposed procedure were adopted, he thought he would have a preference for a meeting on the afternoon preceding the regular morning meeting, although he recognized that it would be hard to find a convenient time.

Chairman Martin said he also thought there was much merit in Mr. Maisel's proposal, and that the Committee might experiment to see how it worked in practice. In his judgment the Committee would want to explore further the question of whether the periodic longer sessions should be scheduled for Monday afternoon and Tuesday morning or for Tuesday morning and afternoon. It was important to avoid any procedure which might lead to caucusing--it clearly was desirable for the members to continue to act independently and not in groups.

The Chairman then suggested that the Committee undertake to experiment with Mr. Maisel's proposal, and that it delegate to Mr. Brill the responsibility for deciding on the date of the meeting that would involve the first longer session.

There was no objection to the Chairman's suggestion.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, July 18, 1967, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

CONFIDENTIAL (FR)

June 19, 1967

Draft of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on June 20, 1967

The economic and financial developments reviewed at this meeting suggest that economic expansion is resuming. Output is still being retarded by adjustments of excessive inventories, but growth in final demands continues strong, reflecting substantial further increases in Government expenditures and also some strengthening of consumer buying. Prices of farm products have turned up recently, but average prices of industrial commodities have remained stable. The pace of bank credit expansion has increased in recent weeks, but is still well below the rapid rate of earlier in the year. Most long-term interest rates have tended to rise further under the influence of heavy securities market financing, and most short-term yields have also increased. The balance of payments deficit has remained substantial despite some improvement in the foreign trade surplus. In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions, including bank credit growth, conducive to renewed economic expansion, while recognizing the need for progress toward reasonable equilibrium in the country's balance of payments.

To implement this policy, while taking account of expected Treasury financing activity, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the same conditions in the money market as have prevailed since the preceding meeting of the Committee, while continuing to utilize operations in coupon issues in supplying part of reserve needs.

ATTACHMENT B

FEDERAL RESERVE BANK
OF CLEVELAND

OFFICE CORRESPONDENCE

TO: Mr. W. Braddock Hickman, President June 13, 1967

FROM: Maurice Mann, Vice President
and General Economist

SUBJECT: Governor Maisel's Memorandum, "Time for FOMC Meetings"

We agree with the proposal to hold extended quarterly meetings of the FOMC. However, we would recommend an additional step; a simultaneous introduction of regular monthly FOMC meetings. As a general matter, it seems to us that the Tuesday in the week following the middle of each month is a suitable time for the monthly meeting, largely because most major economic time series for the preceding month are available by that time (see attached listing). Moreover, we suggest that the "long" meeting be held in the month following the end of each quarter (January, April, July, and October). This not only would fit with the availability of data, but would not be susceptible to an assortment of permanent calendar holidays (February 22, May 30, July 4, Labor Day, Thanksgiving, and December 25).

If the FOMC adopts Governor Maisel's proposal, we recommend that much more comprehensive and complete information be made available at least a week prior to the extended meeting. Specifically, we would request that the Board's staff furnish its quarterly projections in advance of the meeting so that they may be reviewed and evaluated by the research staffs of the individual Reserve banks. This would allow each of the Presidents to be sufficiently briefed as to differences, and similarities, between his own staff's views and those of the Board. As a case in point, it seems extremely difficult for the Presidents to react fully and effectively to next week's chart show (projections) with no advance knowledge of assumptions, substance, and projections by the Board's staff.

Finally, although not necessary to implement Governor Maisel's proposal, we would suggest that consideration be given to having each Reserve bank make available to the Board's staff a uniform set of regional statistics and a regional evaluation on a regular monthly basis. Such information could be collated in Washington and in turn made available to all the Reserve banks (perhaps in the form of a "Brown Book"). This would reduce the need for the Presidents to recite regional statistics at the FOMC meetings, and would allow the Presidents to devote more attention to economic interpretation and discussion of policy recommendations.

Attachment

RELEASE DATE (Approximate)

	Indicator:	Estimate	Preliminary	Revised	Comments:
1.	Industrial Production	n.a.	15th of following month	15th of second following month	
2.	Capacity Utilization	15th of 3rd month of quarter	15th of month following e.o.q.		
3.	Consumer Price Index		23rd of following month		
4.	Wholesale Price Index	23rd of month	23rd of month		Estimates of all commodities, farm products, processed foods and industrial commodities
5.	Rate of Unemployment	n.a.	5th of following month		
6.	Employment-Unemployment	n.a.	6th of following month		Seas. adj. data released 1 day later than rate date

RELEASE DATE (continued)

	Indicator:	Estimate	Preliminary	Revised	Comments:
7.	Unit Labor Cost	n.a.	25th of following month	25th of second following month	Varies with release of *Business Cycle Developments*
8.	Personal Income	n.a.	19th of following month	19th of second following month	
9.	Business Inventories and Sales	n.a.	11th of second following month		
10.	Manufacturers' Shipments and Inventories	n.a.	1st of second following month		
11.	Durable Goods: Sales and Inventories		20th of following month	1st of second following month	New Orders, Shipments, and Inventories only.
12.	Retail Sales	10th of following month (projection from weekly data Fri. a.m.)	10th of second following month	10th of third following month	Estimate includes total durable and nondurable, other data by phone from Board

RELEASE DATE (continued)

	Indicator:	Estimate	Preliminary	Revised	Comments:
13.	Steel Production	n.a.	Tues. of week following month-end	5-10th of second following month	Can project on basis of weekly production
14.	New Car Sales	From Wards by phone as needed	3rd working day of following month		
15.	Retail Sales: 4D	n.a.	22nd of second following month	22nd of third following month	Seas. adj. by FRB Cleveland-MVB
16.	Construction: Put-In-Place	n.a.	12th of second following month	12th of third following month	
17.	Housing Starts	n.a.	16th of following month	5th of second following month	
18.	Bank Reserves	By phone mid-month	By phone, 1st week of following month	26th of following month	
19.	Bank Credit	By phone, 1-2 wks. after month-end	15th of following month		

RELEASE DATE (continued)

	Indicator:	Estimate	Preliminary	Revised	Comments:
20.	Gross National Product	13th of month following e.o.q.	18th of second month following e.o.q.		
21.	Construction-Dodge	n.a.	24th of following month		
22.	Balance of Payments	n.a.	15th of second month following e.o.q.	*Survey of C. Bus.* third month following	

June 13, 1967 (MVB)