MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held on Friday, April 19, 1968, at 2:15 p.m., at the call of Chairman Martin. This was a telephone conference meeting, and each individual was in Washington, D. C., except as otherwise indicated in parentheses in the following list of those participating:

PARTICIPATING:	Mr. Martin, Chairman	
	Mr. Hayes, Vice Chairman	(New York)
	Mr. Brimmer	(Lincoln, Nebraska)
	Mr. Daane	
	Mr. Ellis	(Wellesley, Mass.)
	Mr. Galusha	(Minneapolis)
	Mr. Hickman	(Cleveland)
	Mr. Kimbrel	(Atlanta)
	Mr. Maisel	
	Mr. Mitchell	
	Mr. Robertson	

Mr. Holland, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Hexter, Assistant General Counsel
Mr. Brill, Economist
Messrs. Axilrod, Hersey, Kareken (Minneapolis), Mann (Cleveland), Reynolds, Solomon, and Taylor (Atlanta), Associate Economists

Mr. Bernard, Special Assistant, Office of the Secretary, 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. MacDonald, First Vice President, Federal Reserve Bank of Cleveland (Cleveland)
Mr. Eisenmenger, Vice President, Federal Reserve Bank of Boston (Wellesley)
Mr. Sternlight, Vice President, Federal Reserve Bank of New York (New York)
Mr. Bodner, Assistant Vice President, Federal Reserve Bank of New York (New York)

Chairman Martin noted that this meeting had been called to consider a possible revision of the Committee's current economic policy directive in light of the Board's announcement yesterday that it had approved an increase in discount rates from 5 to 5-1/2 per cent at three Federal Reserve Banks, effective today, and that it had adopted a new schedule of maximum rates of interest payable by member banks on certificates of deposit of $100,000 or more.

The Chairman then asked Mr. Sternlight to review the reaction in financial markets to the Board's announcement.

Mr. Sternlight commented that the market's reaction today had been quite calm and orderly. In general, participants appeared to view the System's actions as constructive in light of current economic problems. Treasury bill rates had risen about 25 to 30 basis points in the 3- and 6-month maturity areas and somewhat more in the 1-year area, where market scarcities had depressed rates earlier. Currently, the 3-month bill was bid at 5.56 per cent; the 6-month bill at 5.68 per cent; and the 1-year bill at 5.70 per cent. Federal funds were trading in a 5-1/2 to 5-3/4 per cent range. Declines in prices of Treasury notes and bonds had been on a sliding scale, ranging from about one point in the longest maturities to 5/8 - 3/4 of a point in the 5- to 7-year maturity area, and to 4/32 of a point in issues maturing within one year. Stock prices had declined; the Dow-Jones industrial average was down a little more than 11 points at 2 p.m.

Following Mr. Sternlight's summary, Chairman Martin asked Mr. Bodner to report on reaction abroad.

Mr. Bodner said that foreign reaction to the Board's announcement had been generally favorable--both that in the press and that reflected in comments of foreign central bank officials to staff of the Federal Reserve Bank of New York. In continental foreign exchange markets the dollar had strengthened against most currencies. The Germans, Belgians, and Swiss had all sold dollars today, and while there had been little change in the Netherlands guilder, the French franc was weaker. Neither the pound sterling nor the Canadian dollar suffered unduly. Sterling was down slightly from yesterday but the Bank of England had taken in some dollars today, and the Canadian dollar was about unchanged. The New York foreign exchange market had been generally quiet. Euro-dollar rates in general were up by 1/4 of a percentage point at the opening, but subsequently they eased and currently were 1/16 or

1/8 of a point above yesterday's close. Euro-dollar trading was quite thin as market participants awaited further developments in the New York money market.

Chairman Martin then read a draft economic policy directive[1/] the staff had prepared for consideration by the Committee. He asked Mr. Sternlight to comment on the manner in which the Trading Desk would interpret the suggested directive in the period until the next meeting of the Committee.

Mr. Sternlight replied that under the directive proposed it would seem appropriate to seek short-term money market objectives that would be as consistent as possible with the new discount rate, against the background of the instruction to attain firmer conditions contained in the directive issued on April 2. Obviously, the particular rate levels that took on significance a few weeks ago--such as a 5-3/8 per cent rate on 3-month bills--had no special relevance now. Higher bill rate levels would now be expected, even granting that there were seasonal influences creating market scarcities of bills at the moment. On the other hand, the Desk would hesitate--unless the Committee directed otherwise--to aim for conditions that quickly pushed such market rates as those on Federal funds, Treasury bills, and dealer bank loans as far above the new discount rate as they had been above the old discount rate

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1/ Appended to this memorandum as Attachment A.

just before the change. If rates approached levels that high, virtually all of the leeway created by the increase in Regulation Q ceiling would be used up quickly. Thus far, major banks appeared to be exercising some restraint in using their new leeway.

Mr. Sternlight went on to say that open market operations in the current statement week were being complicated by at least three factors. One was the availability of large country bank excess reserves carried over from the previous statement week, which could make it hard to keep the money market firm unless net borrowed reserves were very large. Another was the fact that at the moment discount rates differed among Federal Reserve Districts. The split discount rate situation could affect patterns of borrowing at Reserve Banks and flows of funds in the money market. A third complication was the churning in the Treasury's cash balances as April tax payments were received and as sizable calls were made on Treasury deposits at commercial banks to pay off maturing tax anticipation bills.

Those special complications aside, Mr. Sternlight thought that for the time being the Trading Desk would envisage aiming for a Federal funds rate around 6 per cent, fluctuating below as well as above that level; and a 3-month bill rate around 5-5/8 per cent--perhaps ranging between 5.55 and 5.70 per cent. He would expect such rate levels to be associated with a continuation of average member bank borrowings around $700 million, although the possibility could not be ruled out that some variation in borrowings would be needed. Net borrowed reserves consistent with those market rates might be around $300 to $400 million, again with possible variation in either direction in response to special factors.

In a final comment, Mr. Sternlight said the Trading Desk would propose to continue to make flexible but cautious use of rates above the discount rate on System repurchase agreements.

Chairman Martin then called for a go-around of comments by members of the Committee, beginning with Mr. Hayes.

Mr. Hayes remarked that the draft directive prepared by the staff seemed suitable for the period until the Committee's next meeting, which was relatively short. In his judgment the interpretation that Mr. Sternlight had outlined made good sense.

Mr. Brimmer commented that he approved of the draft directive. He noted that its intent was similar to that of the directives the Committee had adopted on two other recent occasions--November 27, 1967 and March 14, 1968--when it also was necessary to adapt open market operations to new circumstances resulting from a discount rate increase. However, he questioned the need for continuing to set the RP rate above the discount rate, since the rise in the latter had brought rates into better alignment.

Mr. Sternlight agreed that money market rates probably would tend to be closer to the discount rate now that the latter had been raised. But if the RP rate was kept at the discount rate, the previous rigidity would be reestablished and the problem that existed earlier would soon be faced again. On the other hand, to continue the practice of setting RP rates above the discount rate in a cautious manner would retain the kind of flexibility that had recently been achieved, and would attract less attention than would a resumption of the practice after it had been discontinued for a time. He emphasized that the Desk proposed to use higher RP rates in a cautious way.

Mr. Daane said he could accept the draft directive, particularly since a similar type of directive issued at the March 14 meeting had proved workable. He would prefer, however, to call for maintaining "the firmer but orderly" conditions in the money market, rather than "firm but orderly" conditions. Since April 2 the Desk had been operating under a directive that called for "firmer" conditions, and to introduce the word "firm" now might suggest to the reader of the record, when it was published, that the Committee had moved away from its earlier goal.

Mr. Ellis agreed that a new directive was needed. He endorsed the staff's draft with Mr. Daane's suggested revision.

Mr. Galusha concurred in Mr. Ellis' statement.

Mr. Hickman said he was disturbed by the implications of the staff's draft directive for policy in the period until the next meeting, and he was not sure that the problem would be resolved by Mr. Daane's proposed revision. The Committee's primary concern should be to fight inflation by restricting the rate of growth of bank credit and the money supply. The draft directive implied too much concern with the state of financial markets and with the leeway under Regulation Q--matters that under present circumstances should be secondary to the rate of growth of money and credit aggregates.

Recent experience had shown that the way to restrict the rate of growth of bank credit was to permit bill rates to press on Q ceilings, Mr. Hickman continued. That pressure reduced the rate of growth of CD's outstanding and, in turn, of bank credit. Thus far in April, for example, the bank credit proxy had actually declined for the first time in many months because of such pressure. Conversely, the failure in late 1965 and early 1966 to validate the discount rate increase of December 1965 had held bill rates below the Q ceilings. That had promoted intermediation and had led to an inflationary expansion of bank credit. To avoid a repetition of the earlier experience he would favor higher bill rates than Mr. Sternlight had suggested were consistent with the staff's draft directive. Specifically, he would want to have the bill rate trending up toward 6 per cent.

Mr. Daane asked whether Mr. Hickman could accept a directive that called for maintaining "firmer but orderly" money market conditions, rather than "the firmer but orderly" conditions, as he (Mr. Daane) had suggested earlier.

Mr. Hickman replied that such a directive would be acceptable to him if it was understood that it called for further firming action to validate the discount rate increase, including a higher target for the bill rate.

Mr. Kimbrel remarked that he had a strong preference for seeking firmer money market conditions, although perhaps he would not go quite as far as Mr. Hickman had suggested. In any case, he certainly would favor using the word "firmer" in the directive.

Mr. Maisel commented that he had no disagreement with Mr. Hickman's objectives. He was not sure, however, that the choice between the words "firm" or "firmer" made much difference, and could accept either.

Mr. Mitchell said he favored achieving firmer money market conditions. He suggested that the directive call for open market operations to "be conducted with a view to achieving firmer but maintaining orderly conditions in the money market, while facilitating market adjustments to the increase in Federal Reserve discount rates."

Other members of the Committee, he believed, were leaning in that direction. He understood that the staff thought there was likely to be quite a problem, in the period before the next meeting, in getting the bill rate up as much as the Committee might like.

Mr. Robertson remarked that in his view the actions taken yesterday to raise discount rates and Q ceilings were intended to tighten and not to maintain existing conditions, and open market operations should not be used to offset their effects. He would not seek to achieve any particular rate patterns, but would want to ratify the move to firmer conditions. He liked Mr. Mitchell's suggested directive language, which indicated exactly what he (Mr. Robertson) wanted to accomplish.

Mr. Robertson added that he would not favor continuing to make System RP's at a rate above the discount rate. He thought the Committee should carefully weigh the matter and review the results of the recent experiment--which in his judgment had had a bad effect--before further operations of that type were undertaken.

Mr. Brimmer indicated that since the previous meeting of the Committee he had given considerable thought to the question of using a rate higher than the discount rate on System RP's. He had spoken to some market participants and had heard about the views of others. In general, he thought the outcome of the recent experiment was still in doubt, and he had hoped the Committee would have a chance to reflect further on the matter. Since rates were now in better alignment as a result of the discount rate increase, he believed it would be useful to refrain from further experimentation at least until the next meeting of the Committee. In the interim the staffs at the Board and the Federal Reserve Bank of New York might review the practice and its implications.

Mr. Hayes noted that some flexibility in the System's RP rate might be useful in trying to achieve a somewhat higher bill rate, and Mr. Hickman concurred.

After some further discussion, Chairman Martin suggested that the decision on further experimentation be left to the Manager until the next meeting of the Committee, when the matter could be reviewed.

The Chairman then observed that the directive language suggested by Mr. Mitchell seemed to be closer to the Committee's wishes than the staff draft.

Mr. Hayes agreed that Mr. Mitchell's proposed wording was appropriate. He (Mr. Hayes) wanted to express a reservation, however, regarding specification of particular objectives such as that of a bill rate of 6 per cent within the next week. So sharp an increase in the bill rate over a relatively short interval might well prove to be disorderly.

Mr. Hickman said that while he favored a bill rate trending up toward 6 per cent, he would not expect that level to be achieved within the next week. Rather, he would press for that rate as promptly as was consistent with the maintenance of orderly market conditions.

Mr. Hickman then inquired whether the Committee was inclined to formulate a consensus regarding the bank credit proxy. Noting that the latest projection indicated that there might be a small decline in the proxy in April, he asked whether the members still considered an annual rate of change in the range of +1 to -3 per cent in that month as appropriate. While there was relatively little time left before the Committee's next meeting, a judgment regarding bank credit growth might still be relevant.

Mr. Mitchell commented that there seemed to be a great deal of uncertainty with respect to how the bank credit proxy might move. Some time was needed for the market to adjust to the discount rate and Regulation Q actions and for the staff to evaluate the new situation. There was only a short interval until the next meeting of the Committee, and he thought it would be a mistake for the Committee to attempt today to specify any particular range for the bank credit proxy.

Mr. Hayes said he agreed completely with Mr. Mitchell's comments.

Chairman Martin then proposed that the Committee vote on a directive along the lines Mr. Mitchell had suggested.

> 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:

> System open market operations until the next meeting of the Committee shall be conducted with a view to achieving firmer but maintaining orderly conditions in the money market, while facilitating market adjustments to the increase in Federal Reserve discount rates.

In reply to a question by Mr. Galusha, Chairman Martin said that the reaction in Washington to the Board's announcement of yesterday appeared to have been favorable for the most part. The White House had issued a statement supporting the actions taken. There had been little reaction thus far from members of Congress, except for a statement of disapproval by Congressman Patman.

Mr. Brimmer reported that he had met with a group of about 40 or 50 businessmen and bankers in Omaha last night, and with another similar group at a luncheon in Lincoln today. In both groups there had been universal applause for the discount rate increase, which was considered desirable in the absence of fiscal policy measures.

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

Thereupon the meeting adjourned.

Secretary

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ATTACHMENT A

April 19, 1968

Draft of Current Economic Policy Directive for Consideration by Federal Open Market Committee at its Meeting on April 19, 1968

System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining firm but orderly conditions in the money market, while facilitating market adjustments to the increase in Federal Reserve discount rates.