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, March 4, 1969, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Bopp
Mr. Brimmer
Mr. Clay
Mr. Coldwell
Mr. Daane
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Scanlon
Mr. Sherrill

Messrs. Francis, Heflin, Hickman, Swan, and Treiber, Alternate Members of the Federal Open Market Committee

Messrs. Morris, Kimbrel, and Galusha, Presidents of the Federal Reserve Banks of Boston, Atlanta, and Minneapolis, respectively

Mr. Holland, Secretary
Mr. Broida, Deputy Secretary
Messrs. Kenyon and Molony, Assistant Secretaries
Mr. Hackley, General Counsel
Mr. Brill, Economist
Messrs. Axilrod, Baughman, Eastburn, Green, Hersey, Solomon, and Tow, Associate Economists
Mr. Holmes, Manager, System Open Market Account

Mr. Sherman, Consultant, Board of Governors
Messrs. Coyne and Nichols, Special Assistants to the Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Keir, Assistant Adviser, Division of Research and Statistics, Board of Governors

Mr. Bernard, Special Assistant, Office of the Secretary, Board of Governors
Miss Eaton, Open Market Secretariat Assistant, Office of the Secretary, Board of Governors

Messrs. Parthemos, Taylor, and Jones, Senior Vice Presidents of the Federal Reserve Banks of Richmond, Atlanta, and St. Louis, respectively
Messrs. Eisenmenger and MacLaury, Vice Presidents of the Federal Reserve Banks of Boston and New York, respectively
Messrs. Garvy and Kareken, Economic Advisers of the Federal Reserve Banks of New York and Minneapolis, respectively
Mr. Shotwell, Assistant Vice President and Economist, Federal Reserve Bank of Cleveland
Mr. Cooper, Manager, Securities and Acceptance Departments, Federal Reserve Bank of New York

The Secretary reported that advices had been received of the election by the Federal Reserve Banks of members and alternate members of the Federal Open Market Committee for the term of one year beginning March 1, 1969, that it appeared that such persons were legally qualified to serve, and that they had executed their oaths of office.

The elected members and alternates were as follows:

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

Karl R. Bopp, President of the Federal Reserve Bank of Philadelphia, with Aubrey N. Heflin, President of the Federal Reserve Bank of Richmond, as alternate;

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

George H. Clay, President of the Federal Reserve Bank of Kansas City, with Eliot J. Swan, President of the Federal Reserve Bank of San Francisco, as alternate;

Philip E. Coldwell, President of the Federal Reserve Bank of Dallas, with Darryl R. Francis, President of the Federal Reserve Bank of St. Louis, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until the election of their successors at the first meeting of the Committee after February 28, 1970, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, as the case might be, they would cease to have any official connection with the Federal Open Market Committee:

Wm. McC. Martin, Jr.	Chairman
Alfred Hayes	Vice Chairman
Robert C. Holland	Secretary
Arthur L. Broida	Deputy Secretary
Kenneth A. Kenyon and Charles Molony	Assistant Secretaries
Howard H. Hackley	General Counsel
David B. Hexter	Assistant General Counsel
Daniel H. Brill	Economist
Stephen H. Axilrod, Ernest T. Baughman, David P. Eastburn, Ralph T. Green, A. B. Hersey, Robert G. Link, J. Charles Partee, John E. Reynolds, Robert Solomon, and Clarence W. Tow	Associate Economists

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System

Open Market Account until the adjournment of the first meeting of the Federal Open Market Committee after February 28, 1970.

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

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

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on February 4, 1969, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee held on February 4, 1969, was accepted.

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

By unanimous vote, the following procedures with respect to allocations of securities in the System Open Market Account were approved without change:

1. Securities in the System Open Market Account shall be reallocated on the last business day of each month by means of adjustments proportionate to the adjustments that would have been required to equalize approximately the average ratios of gold holdings to note liabilities of the twelve Federal Reserve Banks based on the ratios of gold to notes for the most recent five business days.

2. Until the next reallocation the Account shall be apportioned on the basis of the ratios determined in paragraph 1.

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

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

By unanimous vote, authorization was given for the following distribution:

1. Members and Alternate Members of the Committee, other Reserve Bank Presidents, and officers of the Committee.
*2. The Secretary of the Treasury.
*3. The Under Secretary of the Treasury for Monetary Affairs and the Deputy Under Secretary for Monetary Affairs.
*4. The Assistant to the Secretary of the Treasury working on debt management problems.
*5. The Fiscal Assistant Secretary of the Treasury.
6. The Director of the Division of Federal Reserve Bank Operations, Board of Governors.
7. The officer in charge of research at each of the Federal Reserve Banks not represented by its President on the Committee.

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* Weekly reports only.

8. The officers of the Federal Reserve Bank of New York working under the Manager and Special Manager of the System Open Market Account.
9. With the approval of a member of the Committee or any other President of a Federal Reserve Bank, with notice to the Secretary, any other employee of the Board of Governors or of a Federal Reserve Bank.

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

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

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

Such Interim Committee shall consist of seven members, comprising each regular member and regular alternate of the Federal Open Market Committee then available, together with an additional number, sufficient to make a total of seven, which shall be made up in the following order of priority from those available: (1) each alternate at large (as defined below); (2) each President of a Federal Reserve Bank not then either a regular member or an alternate; (3) each First Vice

President of a Federal Reserve Bank; provided that (a) within each of the groups referred to in clauses (1), (2), and (3) priority of selection shall be in numerical order according to the numbers of the Federal Reserve Districts, (b) the President and the First Vice President of the same Federal Reserve Bank shall not serve at the same time as members of the Interim Committee, and (c) whenever a regular member or regular alternate of the Federal Open Market Committee or a person having a higher priority as indicated in clauses (1), (2), and (3) becomes available he shall become a member of the Interim Committee in the place of the person then on the Interim Committee having the lowest priority. The Interim Committee is hereby authorized to take action by majority vote of those present whenever one or more members thereof are present, provided that an affirmative vote for the action taken is cast by at least one regular member, regular alternate, or President of a Federal Reserve Bank. The delegation of authority and other procedures set forth above shall be effective only during such period or periods as there are available less than a total of seven regular members and regular alternates of the Federal Open Market Committee.

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

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

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

in lieu of the Federal Open Market Committee) or when the Federal Open Market Committee (or such Interim Committee) is unable to function.

(1) Whenever it deems it necessary in the light of economic conditions and the general credit situation then prevailing (after taking into account the possibility of providing necessary credit through advances secured by direct obligations of the United States under the last paragraph of section 13 of the Federal Reserve Act), such Federal Reserve Bank may purchase and sell obligations of the United States for its own account, either outright or under repurchase agreement, from and to banks, dealers, or other holders of such obligations.

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

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

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

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

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

Reference was made to the procedure authorized at the meeting of the Committee on March 2, 1955, and most recently reaffirmed on March 5, 1968, whereby, in addition to members and officers of the Committee and Reserve Bank Presidents not currently members of the Committee, minutes and other records could be made available to any other employee of the Board of Governors or of a Federal Reserve Bank with the approval of a member of the Committee or another Reserve Bank President, with notice to the Secretary.

It was stated that lists of currently authorized persons at the Board and at each Federal Reserve Bank (excluding secretaries and records and duplicating personnel) had recently been confirmed

by the Secretary of the Committee. The current lists were reported to be in the custody of the Secretary, and it was noted that revisions could be sent to the Secretary at any time.

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

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

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

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

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

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

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

By unanimous vote, the foreign currency directive given below was reaffirmed:

FOREIGN CURRENCY DIRECTIVE

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

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

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

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

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

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

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

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

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

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

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

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

4. Unless otherwise expressly authorized by the Committee, transactions in forward exchange, either outright or in conjunction with spot transactions, may be undertaken only (i) to prevent forward premiums or discounts from giving rise to disequilibrating movements of short-term funds; (ii) to minimize speculative disturbances; (iii) to supplement existing market supplies of forward cover, directly or indirectly, as a means of encouraging the retention or accumulation of dollar holdings by private foreign holders; (iv) to allow greater flexibility in covering System or Treasury commitments, including commitments under swap arrangements, and to facilitate operations of the Stabilization Fund; (v) to facilitate the use of one currency for the settlement of System or Treasury commitments denominated in other currencies; and (vi) to provide cover for System holdings of foreign currencies.

Chairman Martin then noted that a memorandum from the Secretariat entitled "Proposed technical amendments to authorization for System foreign currency operations" had been distributed to the Committee on February 27, 1969.[1/] He asked Mr. Holland to comment.

Mr. Holland remarked that the Secretariat proposed several changes in the authorization which recent experience had suggested would be helpful in clarifying the Committee's intent. One was to add the phrase "and express authorizations pursuant thereto" at the end of the introductory text to paragraph 1, to make clear that the language of the authorization extended to operations under all

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

express authorities given by the Committee as well as to those under the specific language of the foreign currency directive. It was also proposed to add a new paragraph 1B(1) to cover explicitly the spot side of System warehousing operations for the Stabilization Fund. Those spot transactions were now subsumed under the general language of the existing 1B(1), which authorized the holdings of foreign currencies up to amounts necessary to fulfill forward commitments. Since paragraph 1C(1) authorized forward commitments to the Stabilization Fund, the existing 1B(1) was technically adequate to cover the corresponding spot operations, but the staff thought that use of a separate paragraph for the purpose would be clarifying. Certain other changes were proposed in the various parts of 1B and in 1C(1), of which some--including renumbering--were of a conforming nature, and some were to improve the language. Finally, it was proposed to incorporate more precise descriptions of the System's two swap arrangements with the Bank for International Settlements in the table of paragraph 2 listing authorized swap arrangements.

After discussion, the Committee agreed that the changes in the authorization recommended by the Secretariat were appropriate.[1/]

Mr. Brimmer suggested that the Committee consider a question that it had discussed in the past--namely, whether to withhold for

1/ These changes are incorporated in the text of the authorization shown at a later point in this memorandum.

90 days information on its actions in its organization meetings, such as that of today, with respect to the various continuing authorizations and directives.

Mr. Hackley noted that the following statement was contained in the Committee's rules regarding the availability of information, under the heading "Deferred availability of information:" "For example, the Committee's current economic policy directive . . . is published in the Federal Register approximately 90 days after the date of its adoption . . . ." The passage had been formulated without specific reference to other policy instruments for the purpose of providing flexibility with respect to the timing of public release of information on changes in the other instruments--either to delay release of information considered unusually sensitive for longer than 90 days or to expedite release if that was considered desirable. Thus, making such information available before 90 days would not be inconsistent with the rules currently in effect.

Mr. Holland observed that information on the actions in question would be included in the minutes of actions for today's meeting, the full text of which normally would be available to the public, on request, in 90 days. As Mr. Hackley had suggested, the Committee could agree to make information available sooner on its actions with respect to the continuing authorities. To the best

of his knowledge, however, no request for copies of the minutes of actions for any meeting of the Committee had been received to date.

Chairman Martin remarked that he would expect public interest in the organizational matters dealt with today to focus mainly on the identity of the new members of the Committee from the Reserve Banks.

Mr. Molony said he saw no reason for withholding information on the new make-up of the Committee. Mr. Hayes added that such information would, of course, be published in the March issue of the Federal Reserve Bulletin in the normal course of events.

Mr. Daane noted that the changes the Secretariat had recommended in the foreign currency authorization were intended only to be clarifying and did not involve changes in substance. To publish them in advance of the usual 90-day schedule might only result in a certain amount of confusion.

Mr. Robertson remarked that the issue, as he understood it, was not one of publication but whether to make the information in question available if a request was received before 90 days had elapsed.

In reply to the Chairman's request for comment, Mr. MacLaury said he agreed with Mr. Daane that clarifying changes in the foreign currency authorization were not likely to be of interest to the

public. As the members knew, however, he planned to propose a substantive change in the authorization later in today's meeting. He was not sure at the moment what the implications would be, in terms of release date, if the Committee approved that change.

Chairman Martin then suggested that the matter be held over for consideration at a later meeting of the Committee.

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period February 4 through 26, 1969, and a supplemental report covering the period February 27 through March 3, 1969. Copies of these reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. MacLaury said that there was no change in the Treasury gold stock this week, and he knew of no significant gold transactions coming up. Thus the Stabilization Fund's holdings of $432 million should remain largely intact for the foreseeable future. In the London gold market the price had remained in a range between $42.40 and $42.80 during February with turnover in both London and Zurich quite modest. There had been no indication of South African sales in either of those markets in recent months; nevertheless,

South Africa's foreign exchange holdings had risen from $100 million last November to $200 million now. It still seemed unlikely that South Africa's balance of payments would continue to permit the financing of as large an accumulation of gold in its reserves during 1969 as was the case last year, but to date there was little evidence that they were about to be forced into the market.

Mr. MacLaury commented that the main factor influencing developments in the exchange markets during the past month had been the growing tightness in the Euro-dollar market. Three-month rates, for example, were approximately 3/4 of a percentage point higher today at around 8-1/2 per cent than they had been at the beginning of February. During the first half of the month, that tightening did not reflect any net increase in Euro-dollar takings of American bank branches abroad--in fact, such borrowings were unchanged on balance from mid-January to mid-February. Rather, it reflected mainly developments on the supply side: primarily the cessation of large net outflows from Germany and, to a lesser extent, the required repatriation by French banks of their net assets in the Euro-dollar market. In the last couple of weeks, however, foreign branches of American banks had again been building up their placements with head offices to a peak last week of $8.9 billion, up nearly $3 billion from the end of the year.

Mr. MacLaury remarked that the pull of the high rates in the Euro-dollar market had been felt by most European currencies in recent weeks. Fortunately, sterling had had a fairly good month in spite of the pull of Euro-dollar rates, and the Bank of England was able to announce today a small reserve gain--$19 million--despite $238 million of debt repayments, including $200 million to the International Monetary Fund. The gross gain of over $250 million fairly accurately reflected market developments in February, with buying of sterling triggered by the improved trade figures announced at mid-month but with the Bank of England continuing on balance to acquire dollars on a smaller scale thereafter. Firm indications by Chancellor Jenkins of continuing improvement in British public finances helped give sterling a boost, as did the increase last Thursday in the Bank rate to 8 per cent. The latter move was mainly a reaction to persistent expansion of bank credit in Britain itself but it should also help to offset, for the time being at least, the effects on sterling of high Euro-dollar rates.

The French franc remained largely insulated from external pressures by exchange controls, Mr. MacLaury continued. As he had mentioned, the required repatriation of dollars by French commercial banks seemed to add to the tightness in the Euro-dollar market at times, and it probably accounted for some net inflow to the Bank

of France during the month, although there also was some market covering of forward sales. In the last few days, however, the spot franc had eased despite official support, with the impending confrontation between the Government and the unions on wage negotiations being the major cause of uncertainty. The Bank of France on balance increased its drawings under the swap arrangement with the System by $25 million during February, after two months of paydowns financed mainly by enforced repatriation of privately held foreign exchange.

Mr. MacLaury reported that all the other major continental currencies had been under pressure at times during the month. Maturing forward purchases of dollars by the German Federal Bank exceeded new outflows in early February with a consequent rise in German reserves. However, in the last couple of weeks net exports of funds reemerged, possibly reflecting a reduced trade surplus and conversion of sizable mark borrowings by foreigners in Germany, as well as the pull of the Euro-dollar market. The Italian authorities sold nearly $200 million in the first two weeks of February before deciding to let the spot lira rate fall quite sharply. The guilder also traded below par during most of the month, although reserve losses were small. The Belgian National Bank was able to repay some $27-1/2 million of its drawings on its swap line during the period, but in that case also, the spot rate was under pressure

at times during the month. Finally, additional dollar outflows from Switzerland in February enabled the System to make further paydowns on its Swiss franc drawings, reducing the amount outstanding to $40 million from the recent high of $320 million.

All in all, Mr. MacLaury said, the dollar had shown considerable strength in the major exchange markets since the turn of the year. The reason for that strength clearly was the increasing pull of tightening monetary conditions in the United States. Although the effects of that tightening, particularly as reflected in the rapid rise in Euro-dollar rates and in Euro-dollar borrowings by U.S. banks, had caused some uneasiness on the part of European central banks, there was little evidence as yet of any undue strain from that source on particular currencies or on international financial markets in general.

Mr. MacLaury remarked he might say just a word about the agreement reached at Basle last month concerning possibilities for recycling movements of speculative funds between countries. The memorandum setting forth the governors' conclusions had been released to the press[1/] and, as the Committee knew, the press reports

1/ Copies of the memorandum, dated February 10, 1969, and entitled "Conclusions of the Central Bank Governors of the Group of Ten and Switzerland on Point 8 of the Bonn Communique," together with a letter of transmittal from President Zijlstra of the Bank for International Settlements to Dr. Schiller, were distributed to the Committee on February 26, 1969.

had indicated that nothing new had come out of the central bankers' deliberations on the subject. While it was true that the statement of conclusions might have disappointed those who, for one reason or another, were looking for a large pool of new automatic credit facilities, the fact was that a number of new principles had been agreed upon that could prove most useful in coping with future difficulties. For example, paragraph five of the conclusions stated the governors' belief that "in any new group arrangement designed to recycle speculative flows, both the shares of the participants and the timing of drawings should reflect the direction of the flows involved." Moreover, the paragraph stated that "Central banks that were drawn on and were not gaining reserves at the time should be afforded refinancing facilities for the period of the drawing from other central banks that were gaining reserves at the time." Those principles, if adhered to in any ad hoc credit arrangements set up in the future, could represent a significant step forward in dealing with concentrations of flows among a small number of countries such as had occurred last fall.

Mr. MacLaury then said that the Special Manager, who had not been present at the February 4 meeting of the Committee, had been surprised by one passage in the memorandum of discussion for that meeting. The passage in question was that in which Mr. Maisel

indicated that he continued to feel there was a need for better coordination of Treasury and Federal Reserve foreign currency operations. Mr. Coombs had found it surprising because in his judgment the coordination of such operations had been as close as one might reasonably hope.

Mr. Maisel remarked that he had not meant to raise a question about day-to-day operations, since he recognized that there was full coordination in that area. What concerned him were the much broader questions of over-all coordination in concepts and decision-making with respect to foreign currency stabilization operations of the Federal Reserve and the Treasury.[1/]

> By unanimous vote, the System open market transactions in foreign currencies during the period February 4 through March 3, 1969, were approved, ratified, and confirmed.

Chairman Martin then invited Mr. Daane to comment on developments at the recent meeting in Basle the latter had attended.

Mr. Daane said he had little to add to what Mr. MacLaury had already reported concerning the Basle meeting, which was held

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1/ Subsequent to the meeting Mr. Maisel asked that the following additional observations be included in the record at this point: "These questions arise not only with respect to the Special Manager's operations. Partly they arise with respect to problems of when short-run needs become intermediate-term credit; at what point and how the transfer of the credit source from the Federal Reserve to the Treasury ought to be made; and how agreement should be reached as to whether continued use of System swap lines was tending to become a virtual commitment of longer-term credit."

on the weekend of February 8-9. The principal focus of the meeting was the response to be made to the Bonn communique of November 22, 1968, which had called on the governors of the central banks of the Group of Ten to examine new central bank arrangements to alleviate the impact of speculative movements on reserves. The technical group that had considered the question--in which Mr. Coombs had played a highly useful role--had developed a draft statement that was quite similar to the statement adopted at the meeting on Sunday (February 9).

The agreement could be viewed in various ways, Mr. Daane continued. Mr. Coombs had described it as "the lowest common denominator." His (Mr. Daane's) own feeling was that it represented the best result that could have been hoped for, particularly since it was quite clear that the two countries--Germany and Switzerland--that had been the recipients of speculative inflows were not prepared to agree to an automatic recycling mechanism. He would underscore the point Mr. MacLaury had made that the agreement was a meaningful one. Paragraph five--from which Mr. MacLaury had read--put a great deal of responsibility on the receiving countries both to assume a greater share of the risk of recycling and to offer refinancing facilities to the countries that were not receiving funds. Although the agreement obviously was not what many--including the delegates at Bonn--had hoped for, it seemed nevertheless to be useful.

The Chairman then invited Mr. Brimmer to report on the meeting he had attended of the Economic Policy Committee of the OECD.

Mr. Brimmer commented that the EPC meeting, which was held in Paris on February 10-11, might be described as a follow-up to the "rump" session of last November at which the discussion had been less than satisfactory because of the absence of key German and Italian delegates who were attending the concurrent meeting in Bonn. The February EPC meeting was the first in which the new team at the Treasury and the Council of Economic Advisers participated as senior U.S. representatives--although some, such as Mr. Volcker, had attended such meetings in the past in other capacities.

The chief topic of discussion was that of capital flows, Mr. Brimmer continued. That discussion was particularly useful because of the emphasis placed on the recent enormous inflows to the United States. There were comments about the need for co-ordination to minimize the adverse effects of those flows on other countries, and there were complaints about high U.S. interest rates. The argument was exactly the reverse of that of several years ago when the burden of the complaint had been that the United States, by keeping its interest rates low, was exporting inflation to the rest of the world. This time it was argued that by relying too heavily on monetary policy and permitting interest rates to rise too rapidly, the United States was damaging the growth efforts of

the major European countries. With respect to the Euro-dollar market, suggestions were made--mainly in the form of questions--that the U.S. monetary authorities should take some action to limit the ability of U.S. banks to bid for Euro-dollars. Views on the matter were not unanimous; the Swiss representative, for example, had no objections to the flows to the United States, and Dr. Emminger argued that if reliance had to be placed on monetary policy to fight inflation it was necessary to accept the consequences in the form of higher interest rates. However, Dr. Emminger evidently changed his mind subsequently; in a public statement a few weeks later he urged the U.S. authorities to take some action, perhaps on reserve requirements, to reduce U.S. bank demands on the Euro-dollar market.

Mr. Brimmer went on to say that there also was a good discussion of the surplus countries, Germany and Italy, with the sharper focus on the latter. The Italian authorities were doing very little to increase Italy's rate of economic growth and to reduce its enormous balance of payments surplus. Relative to GNP, the Italian payments surplus on goods and services was considerably larger than that of Germany.

Turning back to the discussion of the U.S. situation, Mr. Brimmer said it was generally expected that this country would continue its fight against domestic inflation. Chairman McCracken

of the CEA stressed the view that stabilization efforts had to be conducted in a way that would avoid excessive unemployment, and that view naturally raised the question of the extent to which the Administration was prepared to allow unemployment to increase in combatting inflation. Mr. McCracken did not respond specifically to that question, but he left the impression that the Administration would persist in its anti-inflationary program. There was general agreement on the desirability of continuing the U.S. capital control program in some form.

Chairman Martin then asked Mr. Solomon to report on the recent meeting of Working Party 3.

Mr. Solomon said the discussion in the WP-3 meeting concentrated first on Italy and then on the general balance of payments situation. Since Mr. Brimmer had already commented on the Italian situation, he would add only one or two observations. As Mr. Brimmer had noted, Italy's surplus was larger than Germany's in a relative sense and it also had persisted for a longer period. The emphasis on the Italian situation in recent international meetings reflected a developing trend toward a more even-handed approach to payments problems, involving discussion of the problems of surplus countries as well as those of deficit countries. It was worth noting that during the whole WP-3 discussion no one suggested, or even hinted, that Italy's surplus had become excessive because deficit countries

were following inappropriate policies--a line of argument that undoubtedly would have been advanced several years ago.

Mr. Solomon commented that Italy's economy currently was growing at a relatively rapid rate. Although there still was some excess capacity, the authorities were hesitant about pressing for a faster rate of growth--which would have the effect of reducing the Italian payments surplus--because of concern over the effects on the internal price level. They also were concerned about the risk that a sizable reduction in their surplus on current account would mean that their over-all payments balance would shift to deficit and remain there, since they expected the current net outflow on capital account to continue in any event. Moreover, they feared that declines in their reserves might stimulate speculation against the lira that would lead to further, cumulative declines. The way in which the Italian authorities formulated their problem was an excellent example of the type of attitude toward reserve management that seemed to make activation of the arrangements for special drawing rights important.

With respect to the general balance of payments situation, Mr. Solomon continued, the question with which the participants in WP-3 were concerned was whether there could be any viable international payments equilibrium, given the objectives of individual countries with respect to the structure as well as the

over-all balance of their external flows. The conclusion to which WP-3 seemed to be coming was that the activation of SDR's might be a necessary precondition for such an equilibrium, not an event that should occur after equilibrium had been attained. He would go into that matter a little further in his statement later in the meeting.

Chairman Martin then asked Mr. MacLaury to present his recommendations.

Mr. MacLaury noted that a $13 million drawing by the Belgian National Bank would mature for the first time on April 11, 1969. That was the only Belgian drawing outstanding at present, and he would recommend its renewal for another three-month period if requested by the Belgians.

> Renewal of the drawing by the Belgian National Bank for a further period of three months was noted without objection.

Mr. MacLaury then noted that a $200 million drawing by the Bank of England would mature for the third time on April 3, 1969. As he had indicated, despite the strains imposed by developments in the Euro-dollar market the British were making headway with respect to their reserves at this point, and if they continued to do so the Bank of England could be expected to make repayments on its swap debt to the System. He would recommend renewal of the drawing if requested by the British,

but for a period of slightly less than three months--specifically, to July 1, 1969. On that basis, if the renewed drawing were outstanding for the full term, the period for which the swap line would have been active would remain within the twelve-month limit which--under the language of paragraph 1D of the authorization--could be exceeded only if specifically authorized by the Committee. During the coming months the Committee would want to focus on the policy question that would be raised if the Bank of England were to propose that the line remain in use for more than twelve months; however, it would be premature to consider that question today.

Mr. Mitchell remarked that in his judgment it would be desirable to consider the question at an early date.

Mr. Brimmer concurred. He noted that he had talked about the matter with Messrs. Coombs and MacLaury before today's meeting and he thought the Committee could not count on the Bank of England's avoiding a request for a further renewal as of July 1. The safer assumption was that they would need some additional accommodation at that time. That being the case, he thought the staff should begin very soon to consider possible alternative means, perhaps involving assistance from the Treasury, of providing what would in effect be intermediate-term financing to the British. It would be unfortunate if the System found itself obliged to extend

intermediate-term credit under the swap line simply because of the lack of time to work out other arrangements.

Chairman Martin suggested that the staff be asked to prepare a memorandum on the subject and that the Committee plan on considering the question in the course of its next few meetings.

There was general agreement with the Chairman's suggestion.

Mr. Solomon noted that the bulk of the Bank of England drawings now outstanding had been initiated in November 1968; apart from the drawing Mr. MacLaury had mentioned and two others of $50 million each, individual British drawings would not be outstanding for a full year until November 1969. Thus, if the Committee was prepared to focus on the duration of the main part of the British swap debt, rather than on the period for which any use had been made of the line, substantial time would be available.

Renewal until July 1, 1969 of the $200 million drawing by the Bank of England was noted without objection.

Mr. MacLaury then observed that a memorandum from the Special Manager recommending an increase in the limit on the System's outright holdings of foreign currencies specified in paragraph 1B(2) of the foreign currency authorization--which would now be paragraph 1B(3) under the amendments to that instrument that had been agreed upon earlier today--had been distributed to the

Committee on February 28, 1969.[1] He apologized for the fact that the members had had only a relatively short time to consider the recommendation.

As the memorandum noted, Mr. MacLaury continued, the proposal was to increase the limit on outright holdings of authorized currencies from $150 million equivalent to $250 million. The present limit of $150 million had been established in 1963, and since that time the scale of the System's foreign currency operations had grown considerably. The System's outright holdings had risen to nearly $140 million, largely as a result of market purchases of German marks in recent weeks, so that the leeway remaining at present was only a little over $10 million. As on an earlier occasion in 1966, the Special Manager had thought it desirable to accumulate mark balances, since marks were trading well below par and the balances were likely to prove useful for market operations or to repay swap drawings on the German Federal Bank if such drawings should prove necessary. Moreover, the Treasury had indicated that it would be prepared to purchase any marks which the System found it did not need to help cover the Treasury's outstanding mark-denominated debt.

Mr. MacLaury remarked that the $100 million increase in the limit recommended would permit the System to continue buying

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

marks in the market at a modest rate. In his judgment the recent purchases--which had come to $127 million over a period of about 5 or 6 weeks--were accurately described as modest. Although they added to member bank reserves, the System Account Manager had advised that mark purchases on such a scale did not pose problems for domestic operations.

Mr. Mitchell said he did not understand the rationale for System acquisitions of foreign currencies that was implied by the Special Manager's memorandum and Mr. MacLaury's comments today. The principle suggested seemed to be that it was desirable to accumulate an authorized currency because it was trading well below par. The matter might be academic in the present instance, in view of the Treasury's need to repay mark-denominated debt, but it was not clear to him whether the Account Management would have been buying marks recently in the absence of that need.

Mr. MacLaury replied that the fact that the Treasury had mark debt outstanding removed the element of risk from System holdings of marks and made the decision to accumulate them a relatively simple one. However, it undoubtedly would have been considered desirable to acquire marks even in the absence of the Treasury's need. The objective was not to acquire a currency simply because it was trading below par, but to take advantage of existing market availabilities to accumulate modest holdings

of a currency that was likely to prove useful for future operations. An additional reason for the current mark acquisitions was to operate in parallel with the German Federal Bank, which had been buying marks recently in a stabilization operation designed to moderate the decline in the exchange rate.

In his judgment, Mr. MacLaury continued, decisions regarding purchases of particular currencies should be made on a case-by-case basis, looking mainly toward the System's likely future needs. In that connection he might note that apart from marks and about $3-1/2 million of guilders, the System held only nominal amounts of foreign currencies outright at the moment. From time to time there was a modest accumulation of uncovered sterling as a result of earnings in connection with British swap drawings. Those holdings were used mainly to meet the needs of the U.S. Disbursing Officer in London.

Mr. Daane said he personally was quite sympathetic to the recommendation. In his judgment the present situation was closely analogous to that of 1966, when marks acquired by the System had proved useful. Moreover, the operations in marks were consistent with the spirit of the agreements that had been reached in Frankfurt in November 1967, following the devaluation of the pound, regarding coordinated action to ensure orderly exchange market conditions. In general, he was sympathetic with

the concept of giving the Special Manager the necessary latitude to operate as needed to help normalize exchange market conditions, for the purposes of protecting the dollar and cooperating with other central banks--in this case, the German Federal Bank. His only question was whether the $100 million increase in the limit that had been proposed was adequate, but he was prepared to accept the Special Manager's judgment on that question.

Mr. MacLaury commented that one consideration affecting the desirable scope for System holdings of foreign currencies was that opportunities for investing such holdings were limited. He added that in the case of the mark there were special arrangements with the German Federal Bank that somewhat alleviated the problem.

Mr. Mitchell observed that while he had no objection to the acquisitions of marks he still thought the principle that guided the Special Manager's decisions with respect to acquisitions of particular foreign currencies was unclear. One possible course would be for the Committee to approve a $100 million increase in the authority but to restrict its use to marks. The Account Management already had authority to acquire a certain amount of foreign currencies outright. If at some future time the Special Manager concluded that it was desirable for the System to take a larger position in some currency than existing authorities permitted, he could make a specific recommendation which the Committee could judge on its merits.

In response to Mr. Daane's comment that a limit of $250 million on total outright holdings of foreign currencies did not appear to be large, Mr. Mitchell remarked that the limit might be expanded in the future.

Mr. Maisel asked whether Mr. MacLaury would amplify on his comment regarding the special arrangements that had been made with the German Federal Bank in connection with the problem of investment of System mark balances. Concerning the observation that purchases of marks by the System were useful partly for stabilization purposes, he asked how the appropriate roles of the System and the Treasury's Stabilization Fund might be distinguished.

In response to Mr. Maisel's first question, Mr. MacLaury said that, as the Committee knew, the Federal Reserve did not have legal authority to invest its foreign currency balances in securities of foreign governments. Accordingly, it had opened time deposits in marks with the BIS, which in turn invested the balances in the Euro-currency market. However, the German Federal Bank preferred not to have the volume of such investments grow too large. Under the special arrangements he had mentioned the System held some of its mark balances uninvested and the German Federal Bank held an equivalent amount of uninvested dollar balances. With respect to the second question, from the time the System first undertook foreign currency operations in 1962, its objective had

been to work closely along with the Treasury in exchange market stabilization operations.

Mr. MacLaury then said he might comment on Mr. Mitchell's suggestion that the Account Management should seek specific authority for sizable acquisitions of particular foreign currencies when it considered such acquisitions desirable. Obviously, there could be differences of opinion with respect to the latitude that should be given the Desk for particular types of operations. In his judgment, however, the $250 million limit now recommended for outright holdings would not involve an unduly large degree of latitude--relative, say, to that involved in a $150 million limit under the circumstances of 1963. In general, he hoped the Committee would feel it could count on the Special Manager not to use the expanded authority to acquire unnecessary, and perhaps weak, foreign currencies.

Mr. Brimmer noted that Mr. Coombs' memorandum said the prime consideration underlying recent operations in marks had been "to accumulate mark balances against the very real possibility of a market rebound that would make it desirable for the System once again to engage in spot or forward sales of marks or to draw heavily on the swap line with the Federal Bank." He (Mr. Brimmer) asked whether the System was likely to find it necessary either to draw on the swap line or to sell marks out of its balances in the near term.

Mr. MacLaury replied that the answer probably would depend on how "near term" was defined. While one could not speak with certainty in matters of the present sort, at the very least it seemed probable that the System would have a need for marks around the end of the year--when seasonal pressures normally built up--if not much sooner in connection with some market disturbance.

Mr. Brimmer then said he was prepared to support the Account Management's recommendation, on the basis that there was likely to be a need for the mark balances that were being accumulated.

Chairman Martin said he also was prepared to support the recommendation. It would be important, he thought, for the Special Manager to keep the Committee informed on his use of the expanded authority and for the members to keep the matter under review.

The Chairman then noted that Mr. Coombs' memorandum had been distributed only a few days before today's meeting. He thought that was unfortunate, and he hoped that in the future it would ordinarily prove possible to give the members more time to consider such memoranda.

Mr. Hickman asked whether the accumulation of marks by the Federal Reserve might result in requests from other central

banks, including those of countries with weak currencies, for similar System operations in their currencies.

Mr. MacLaury replied that he could not recall such requests in the past and would not expect any problems of that sort to arise. The existence of the swap network offered the System's partners an alternative means of acquiring needed dollars and thus reduced the chances that such requests would be received. In any case, the Account Management had always made it a point to preserve the System's initiative with respect to uncovered purchases of foreign currencies, and would continue to do so.

Mr. Hickman then said that he thought the current purchases of marks were quite appropriate, and he hoped they did not lead to pressure on the System to acquire other, undesired, currencies on an uncovered basis. He also hoped the Special Manager would consult with the Committee before undertaking sizable uncovered purchases even of strong currencies, since political or other developments could bring almost any currency under sudden pressure.

Mr. Hayes said he was sure the Committee could count on the Special Manager to resist requests to acquire undesired currencies.

Chairman Martin agreed, but added that it might be helpful to Mr. Coombs to know he had the support of the Committee

on the matter. He thought it was important for the members always to keep in mind the possible impact of information on the Committee's actions when that information was published.

The Chairman then remarked that the Committee seemed to be prepared to approve the Special Manager's recommendation, on the understanding that operations under the enlarged authority would be kept under close review.

By unanimous vote, the authorization for System foreign currency operations was amended to read as follows:

AUTHORIZATION FOR SYSTEM FOREIGN CURRENCY OPERATIONS

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

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

Austrian schillings
Belgian francs
Canadian dollars
Danish kroner
Pounds sterling
French francs
German marks
Italian lire
Japanese yen
Mexican pesos

Netherlands guilders
Norwegian kroner
Swedish kronor
Swiss francs

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

(1) Currencies purchased spot, including currencies purchased from the Stabilization Fund, and sold forward to the Stabilization Fund, up to $1 billion equivalent;

(2) Currencies purchased spot or forward, up to the amounts necessary to fulfill other forward commitments;

(3) Additional currencies purchased spot or forward, up to the amount necessary for System operations to exert a market influence but not exceeding $250 million equivalent; and

(4) Sterling purchased on a covered or guaranteed basis in terms of the dollar, under agreement with the Bank of England, up to $300 million equivalent.

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

(1) Commitments to deliver foreign currencies to the Stabilization Fund, up to the limit specified in paragraph 1B(1) above;

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

(3) Other forward commitments to deliver foreign currencies, up to $550 million equivalent.

D. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding

at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	100
National Bank of Belgium	225
Bank of Canada	1,000
National Bank of Denmark	100
Bank of England	2,000
Bank of France	1,000
German Federal Bank	1,000
Bank of Italy	1,000
Bank of Japan	1,000
Bank of Mexico	130
Netherlands Bank	400
Bank of Norway	100
Bank of Sweden	250
Swiss National Bank	600
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,000

3. Unless otherwise expressly authorized by the Committee, all transactions in foreign currencies undertaken under paragraph 1(A) above shall be at prevailing market rates and no attempt shall be made to establish rates that appear to be out of line with underlying market forces.

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

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

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

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

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

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

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

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

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

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

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 February 4 through 26, 1969, and a supplemental report covering February 27 through March 3, 1969. Copies of both reports have been placed in the files of the Committee.

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

As the written reports to the Committee indicate, market sentiment shifted decisively towards expectations of sustained monetary restraint during the period since the Committee last met. The dominant mood contrasted sharply with the air of skepticism about Federal Reserve policy that existed in mid-January. Steady pressure on bank reserve positions through open market operations contributed to this shift in sentiment. With CD attrition continuing, banks began to find that adjustment

alternatives were becoming more difficult--and expensive--as interest rates rose and as their liquid assets ran down. Euro-dollars were not as readily available. With the three-month rate now at 8-7/16 per cent, Euro-dollars have become an expensive alternative to CD's. In addition to market developments, testimony before Congress by Chairman Martin and by Administration spokesmen stressing that inflation was the number one domestic problem requiring an extended period of monetary restraint played a significant role in the change of market sentiment. A number of market observers, however, still remain unconvinced that restraint will be maintained--as they believe it should--once signs of a slowdown in economic growth become apparent; and others feel that a money crunch--somehow defined--cannot be avoided if inflationary expectations are to be eliminated.

There were healthy signs during the period that the stock market was also being affected by the change in expectations. Warnings from responsible sources on conglomerates and on speculative new issues, together with prospective action on one-bank holding companies, contributed to the more cautious atmosphere.

By the close of the period, as banks increased their efforts to liquidate intermediate-term securities, the market was anticipating some further action on the interest-rate front--either a further increase in the prime rate alone or some further move on the monetary policy side that would trigger a move in the prime rate. The increase in the British Bank rate on Thursday (February 27) intensified these expectations, but the general market reaction to the British move was quite moderate.

Given the general market attitude, a strong demand for short-dated Treasury bills developed during the period from investors seeking a safe haven while awaiting interest rate developments. On balance, the three-month rate changed very little over the period, although for a time in February it had dipped close to the lower end of the 6 to 6-1/4 per cent range anticipated at the last meeting of the Committee. In yesterday's regular Treasury bill auction average rates of 6.22 and 6.34 per cent were established for three- and six-month Treasury bills, down only a couple of basis points from rates set in the auction just preceding the last meeting of the Committee.

The technical position of the bill market remains quite strong, with numerous dealer short positions in

short-dated Treasury bills. In general, Government securities dealers have lightened their positions over the past month. At the end of February dealer positions in all maturities aggregated only $2.3 billion, $1.4 billion below the end-of-January level. Nonbank dealer use of bank credit has declined correspondingly; in fact on one recent day dealer operations provided the New York banks with reserves on balance, reflecting the very heavy volume of short sales made by the dealer departments of the banks.

Looking to the future, the Treasury bill rate will be subjected to conflicting pressures in the weeks ahead, as the blue book[1/] stresses. The 6 to 6-1/4 per cent range anticipated in the blue book appears reasonable, but higher rates could develop before the March tax date, particularly in the event of a prime rate change, and lower rates later on as the Treasury begins to pay off debt. I have little to add to other blue book expectations about the short-term monetary variables that concern us. From time to time I expect that we may be faced with deviations from the expected pattern of the Federal funds rate and bank borrowing--depending on bank adjustment policies--that will not be of any particular longer-term significance.

As you know, the credit proxy for February, adjusted for Euro-dollars, rose at an annual rate of 2 per cent, compared to the zero to 3 per cent decline expected at the time of the last meeting. This somewhat stronger result was only known on the last day of the month; earlier estimates of the proxy had indicated a decline in about the range anticipated. For January and February combined the proxy plus Euro-dollars shows no change, although month-end bank credit figures indicate a growth rate of just under 3 per cent in both months. For March a decline of 3 to 6 per cent is expected in the proxy--assuming Euro-dollar borrowings remain at current levels. Provided that this anticipation is borne out there would be a small decline, at an annual rate of a per cent or two, in the average proxy for the first quarter. Very preliminary estimates indicate that the credit proxy will show some expansion in April.

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

The credit estimates, and interpretation of a proviso clause, may pose some difficult problems in the weeks ahead. Presumably, the Committee would wish to avoid a sharp decline in bank credit, particularly if accompanied by strong pressures on financial markets, but any significant relaxation of day-to-day money market conditions could generate market suspicions that the System was drawing back from a policy of sustained restraint. On the other side, a credit decline that proceeds unchecked for long could lead to market expectations that the System was ready to countenance a severe credit "crunch." At some point, if pressures become extreme, it may become desirable to consider modification of Regulation Q as an alternative to relaxation of money market conditions. Fine tuning of money market conditions to provide for moderate credit growth may indeed be difficult to achieve, and a highly flexible approach may be necessary.

In this context, the Committee's interpretation of the proviso clause of the directive is of considerable importance for the weeks just ahead. One possible interpretation would be to permit considerable leeway for a stronger proxy than is currently projected before implementing the proviso on the tighter side. On the other hand, the proviso might be implemented on the somewhat easier side if the decline in the proxy approaches the lower end of the currently projected range. Any move towards somewhat easier money market conditions triggered by a substantial decline in the proxy might have to be tempered if the market began to suspect that the System was turning away from a policy of over-all restraint.

As far as open market operations in the weeks ahead are concerned, a flexible approach appears to be called for. Current projections do not call for much in the way of reserve supply, but there may be room for some judicious run-off of our heavy holdings of maturing Treasury bills, thereby opening up room for modest purchases of coupon issues that could assist the banking system in making liquidity adjustments.

As far as the Treasury is concerned, the results of the February refunding illustrate once again the difficulties of Federal financing in an inflationary atmosphere. Attrition was heavy and bank and dealer underwriting minimal in the light of uncertain interest

> rate expectations. The Treasury will have a major undertaking on its hands to increase the average maturity of the debt, as it would clearly like to do. The best hope--barring a major break in inflationary expectations and pressures--is through some change in the interest rate ceiling that would permit advance refundings once again. It is encouraging that the Treasury has indicated its intention to press for new legislation in this area.
>
> As you know, the Administration is also seeking a change in the debt ceiling. I understand that hearings are scheduled to begin tomorrow in the Ways and Means Committee. There is, of course, no guarantee of action before the seasonal problem emerges in April. The Treasury still expects to need about $2 billion in cash in April, although Federal Reserve projections of the Treasury's cash position are more optimistic than the Treasury's own forecast. Treasury projections would still indicate that the twin problems of cash needs and debt ceiling might require special recourse to the Federal Reserve some time during April.

Mr. Mitchell observed that market psychology and the market's interpretation of System policy seemed increasingly to be influenced by changes in M_1--the money supply narrowly defined. The staff currently was projecting a 6 to 9 per cent rate of expansion in the money stock in March as a result of an expected sizable decline in the Treasury cash balance. He wondered what sort of defensive operations the System might undertake to offset or neutralize the flow of Treasury funds into private deposits and what the resulting impact on other money market indicators might be.

Mr. Holmes replied that he found it hard to answer that question since it was often more difficult to anticipate short-run

movements in the money stock than in other monetary aggregates. In any event, he did not think the market tended to focus primarily on changes in the money stock; market expectations were importantly influenced by changes in interest rates as well as by those in other aggregate measures. At the moment, the dominant attitude in the market was that pressures were bound to increase as CD attrition continued. In adjusting to that attrition many banks had already run through their short-term assets and were beginning to dispose of intermediate-term securities.

Mr. Mitchell then noted that Mr. Holmes had suggested the possible desirability of some modification of Regulation Q ceilings if pressures in the money market became severe. In recent weeks there had been a net inflow of funds from the Euro-dollar market, but continued availability from that source could not be predicted. Assuming the Euro-dollar well ran dry, it might become necessary to encourage member bank borrowing from the System or to raise Regulation Q ceilings in order to provide some relief to the banks without easing money market conditions. If that were done, however, the System would lose ground in its efforts to control bank credit. Thus, he returned to his original question about what could be done to control M_1.

Mr. Holmes replied that in his opinion it was not feasible to attempt direct control of short-run movements in the money stock.

The Desk could, of course, be instructed to tighten money market conditions each time M_1 seemed to be expanding too rapidly and to ease such conditions in the opposite situation. However, efforts at close control over short-run fluctuations in M_1 could involve drastic medicine. He noted in that connection that the New York Bank staff was tentatively projecting that the rapid run-up in M_1 in March would be followed by a decline in private demand deposits at a rate of around 14 per cent in April.

Mr. Maisel observed that fluctuations in Treasury cash balances accounted for the bulk of the short-run movements in the money stock. Accordingly, if movements in M_1 were the basic problem to be resolved, serious consideration should be given to turning over the management of M_1 to the Treasury or at least to getting the Treasury to cooperate in such management.

Mr. Mitchell noted that the System was continually engaging in defensive open market operations to offset undesired effects of various developments. Defensive operations could also be undertaken to offset movements in Treasury cash balances if the latter were creating fluctuations in M_1 that had unwanted effects on the market's interpretation of System policy.

Mr. Daane remarked that it was important to consider the impact of operations not only on M_1 but also on reserves. As

Mr. Holmes had implied, actions to keep M_1 under control could produce undesirable consequences for reserves and bank credit.

Mr. Mitchell commented that the solution to that problem would seem to be to raise Regulation Q ceilings, although there might be questions about the appropriate timing of such an action.

Mr. Brimmer asked whether his impression was correct that projections of bank credit had tended to prove less reliable recently than in the past. The Manager had noted that the increase in the adjusted bank credit proxy in February--at a 2 per cent annual rate--had become evident only on the last day of the month. At the time of the last meeting of the Committee the February projection, which appeared to have been offered with a reasonable degree of confidence, had been for a decline in the adjusted proxy at a zero to 3 per cent annual rate.

Mr. Holmes replied that the magnitude of the recent revisions did not seem unusual to him. At the same time, the weekly changes in the projections for a particular month--which often were in opposite directions in successive weeks--highlighted the danger of moving to implement the proviso clause as soon as a revision in the projection suggested that bank credit was deviating from earlier expectations.

Mr. Brimmer noted that the possible need for an increase of Regulation Q ceilings had been suggested. He wondered how the

potential benefits of such an action could be reconciled with the possible undesirable effects on market psychology.

Mr. Holmes indicated that it was difficult to evaluate the benefits and costs of such an action under current circumstances. At the moment market expectations seemed to be poised to move in either direction. An increase in the prime rate could, for example, trigger aggressive selling of securities and quickly lead to a crunch. He personally did not expect a crunch to develop in the period ahead, partly because banks had been doing a good job of anticipating tax-date pressures; given the prevailing uncertainties, they had been managing their money positions cautiously, which was all to the good. The possibility remained, nevertheless, that market pressures could increase to the point at which some type of relief might be required.

Mr. Brimmer observed that in his recent conversations with bankers around the country he had formed the impression that the word "crunch" currently meant something other than it had in 1966. Today it seemed that the word was used to refer to a situation in which it was necessary for banks to sell coupon securities at a loss in order to meet loan commitments.

Mr. Holmes indicated that banks were already being forced by the large CD attrition to sell securities at a loss, and such adjustments were becoming more difficult and more expensive for them.

Mr. Brimmer commented that in his judgment such a development had been intended under current monetary policy. The more losses banks experienced on sales of securities, the more pressure they would be under to make adjustments in their lending operations.

Mr. Hayes said he thought Mr. Brimmer's observation was correct up to a point, but determination of that point was quite difficult. If carried too far, a policy of restraint could result in a flood of securities being sold into an unreceptive market; in that connection the municipal market might be particularly vulnerable. Moreover, there could be highly undesirable consequences in terms of market psychology. By and large, borrowers had responded calmly thus far to indications that monetary policy was getting tighter; there had been no repetition of the developments of 1966 when a surge of requests for banks to honor firm loan commitments had snowballed into a panicky market atmosphere. In his view it seemed desirable to maintain firm but steady pressure in order to minimize the risks of such developments.

Mr. Hickman commented that while the projections indicated that the money stock would grow rapidly on average in March, they showed little change between the end of February and the end of March. To avoid a mistaken psychological reaction in the market to the higher average level of the money stock in March, it might

be desirable to offer an official explanation--possibly in the form of a speech--of the temporary nature of the expansion and its relation to movements in Treasury cash balances.

> By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period February 4 through March 3, 1969, were approved, ratified, and confirmed.

The Chairman then called for the staff economic and financial reports, supplementing the written reports that had been distributed prior to the meeting. Copies of these materials have been placed in the files of the Committee.

Mr. Brill made the following statement concerning economic developments:

> While we are all grateful for even fragmentary indications that some steam is being let out of the boom, I for one would be a lot more comfortable about the ultimate success of our restraint program if the evidence of slowing was a little broader and not so largely confined to the consumer sector. By and large, businessmen seem less concerned with current indications of slowing in final demands than with prospects of resurgence in the future and with the pressure of rising wage costs on their profit margins.
>
> But there can be little doubt, any longer, that the consumer is not a source of economic strength. The January pick-up in retail sales did not carry very far; weekly sales data for February suggest no further rise, and perhaps a slight decline. While the flu and bad weather probably play a small part in this, the underlying factor has been the slower growth in disposable incomes and the prospects of continuing large tax bites in the months ahead. These more basic factors are being reflected in recent surveys of consumer

attitudes and spending plans, which do not offer the likelihood of a resurgence in consumer demands in the near future.

So far, the principal recognition, at the business level, of the protracted drifting off in consumer demands has been in the auto industry, where sales have been slipping since last fall. In both January and February, auto output was cut short of original production schedules. Despite this, inventories of new cars have risen, and March production schedules have been cut back sharply from those announced earlier.

There is a possibility that producers of other consumer goods may be falling in line. The information on manufacturers' inventories for January, just received, indicates that producers' stocks of nondurable goods and of consumer durables other than autos were reduced significantly in January. Overall, the rise in manufacturers' inventories was very small, following the large increase in December. So some business adjustment may be under way. But continued production increases in lines such as appliances and furniture make one leery of broad assessments.

One other area of adjustment is worth noting. Prices of consumer industrial products--at wholesale and retail--have been rising at a slower pace since last fall than the general price indexes. This is especially marked at the wholesale level, where the increase in consumer goods prices since October has been at an annual rate of less than 1 per cent, compared with the 4.0 per cent rate of rise for all industrial commodities.

But these bits of evidence that slowing at the consumer level is working back to influence some producers' behavior are outweighed by the many indications that the business sector as a whole is still orbiting in a different plane. Demands for labor are strong, with much of it--we suspect--reflecting hoarding of scarcer skills. For many materials and products, there is little reluctance to test the market with announced price increases. And, probably most significant, business plans for capital spending appear strong. I don't put much credence in some of the private surveys, which appear to be mainly advertising vehicles for their

sponsors, without much attention to standards of statistical reliability and without good track records. But one of the more reliable--the NICB survey of capital appropriations by large manufacturing companies--recently showed great strength in new appropriations and appropriation backlogs. In light of this survey, and the confidential Commerce survey reported to you earlier, it will be surprising if the upcoming official survey, due in a week, indicates any slackening in business demands for capital goods.

The continuing dichotomy between consumer and business behavior poses a serious problem for policy makers. So long as businessmen doubt the ultimate success of stabilization policies, they will continue to add to demands for materials, machinery, and labor, keeping up the pressure on prices and wages. Certainly, the business and financial communities--aided and abetted by an aggressive financial press--will be alert to the slightest move in any financial variable that conveys a hint that policy is backing away from restraint.

But in our concern to succeed in cooling-off the economy, we can't lose sight of the cumulating financial effects of the restraint exercised so far, and the impacts these will have, with a lag, on the real economy. It seems to me that the present stance of policy, if continued, could generate more financial restraint than we need or could afford for the longer term. Even if last fall's growth rates of bank credit were too rapid, we can't restore economic equilibrium by averaging past excesses with current contraction. The trick is to get back on a moderate credit growth path, and then stay there until some results are achieved in the real economy.

Thus, I approach with trepidation a policy estimated to result in a significant further contraction in bank credit in March. I smell "crunch" in the air. This, I submit, would be a failure, rather than a success, of policy making.

On the other hand, it is hard to find enough economic signals to support the thesis that the time has come to ease up overtly on the monetary reins. Perhaps what we need is a combination of actions, designed to permit some resumption of bank credit flows but at higher costs to all participants. Such

a combination might include higher reserve requirements throughout the banking system, higher Q ceilings, and a higher discount rate. It would not be inconsistent, I believe, with the policy objective outlined in the staff's February projection: it would avoid a complete drying up of bank credit, but would limit the potential expansion and make it more costly.

But such a package would be strong medicine, indeed, and probably ought to be regarded as an emergency measure to avoid a complete blockage of fund-flows through the banking system during a period when a severe posture of monetary restraint must be maintained. If we can get through the next few weeks without having to call up all this artillery, so much the better. Some elements of the package might still be useful in countering too much downward pressure on rates in early spring, when markets may begin to anticipate Treasury debt repayment.

Mr. Axilrod made the following statement regarding financial developments:

Financial markets remain perplexing, though perhaps somewhat less so than several weeks ago. The policy of monetary restraint being pursued by the Federal Reserve has had an increasing impact on markets, and few financial observers appear any longer to question our determination. On the other hand, there is some question, on the part of banks particularly, about how long and how far the current policy can be pursued without tending to something in the nature of a "crunch", and thus requiring some restructuring in existing relationships among Federal Reserve monetary policy and regulatory instruments. But any such need does not depend only on the impact of existing Federal Reserve policy. It depends also, and importantly, on the intensity and structure of credit demands and on market psychology. Thus, perhaps the most helpful analysis to offer the Committee, at this point, is to attempt to sort out demand forces, supply constraints, and psychology, although recognizing that the three are not mutually independent.

On the demand side, the recently available flow-of-funds data make it clear that private credit demands continued to be very strong through the fourth quarter. Consumer credit, bank loans to businesses, corporate security issues, and mortgages all showed as much or more strength than in the third quarter. The Federal

Government, meanwhile, was the principal source of lower credit demands, as its fourth-quarter borrowing was at a less than seasonal pace.

The rapid pace of fourth-quarter private borrowing may not have been fully maintained into early 1969, although the partial nature of the data thus far available and the difficulties in evaluating seasonal influences in the financial area make this judgment very hazardous. State and local government bond offerings appear to be moderating somewhat under the pressure of cancellations and postponements, and the gradual slowing of consumer instalment credit expansion that began in late 1968 seems to be continuing. In the corporate bond market, the volume of new issues has at least not shown a tendency to build up significantly. And businesses do not yet appear to be taking down the sizable overhang of bank commitments in any accelerated fashion, though their actual rate of borrowing has continued on the strong side. Mortgage credit demands remain high.

While private credit demands may not be burgeoning, any weakening thus far is probably only modest at best. Thus, with Federal Reserve policy restricting the growth of bank reserves and bank credit to close to zero and leading to a further slowing of net inflows of funds to thrift institutions, interest rates so far in 1969 have generally returned to around advanced levels reached in late 1968 or early 1969, or have moved upward. It has been mostly long-term rates that have risen above earlier peaks, with the largest rise in mortgage yields and the next in interest rates paid by State and local governments.

The rise in long-term rates reflects in the main adjustments that are being made by institutional lenders to the reduced supplies of funds. Because of limited inflows of funds, thrift institutions have charged higher interest rates on mortgage loans; to lock in these high yields they have also continued to increase their commitments, with the result that a substantial potential demand on Federal Home Loan Banks has built up. Potential demands on FNMA have also been built up to substantial size as lenders have bid aggressively for forward commitments of funds.

With respect to banks, major reporting banks have run through a considerable amount of liquidity since the CD run-off began in December, with the result that they have found it increasingly necessary to withdraw from the

municipal market, sell longer-term U.S. Government securities, and stiffen their attitude toward mortgage lending. In addition, of course, they have tightened lending terms and conditions on business loans, as the mid-February Lending Practices Survey shows. However, this tightening of lending terms to business, while it may have affected some marginal borrowers, does not appear to have been so severe as to have caused a pick-up in demands in corporate bond markets.

The failure so far of the corporate bond calendar to build up is not just a reflection of banks' continued efforts to hold on to corporate customers, however. It may be that some of the edge is now being taken off inflationary expectations, and that businesses do not see an urgent reason to anticipate their longer-term credit needs, although we do not have figures yet that would suggest spending plans have been revised down. The recent stock market decline may be a little harder evidence of moderating expectations, with more of the public coming to believe that monetary policy is biting and that a more noticeable slowing in economic expansion is becoming likely.

This brief review of recent tendencies in demand, market psychology, and supply suggests a modest abatement of demand from a few private sectors, and the hesitant beginnings of less exuberant market attitudes. But both such developments are tenuous as of now. For instance, the recent upward revisions in bank deposits and money supply data may suggest that credit and transaction demands have been a little larger than were folded into earlier daily and weekly projections.

If we are to be more certain of constraining demands and moderating an over-ebullient psychology--as is desirable--this would appear to depend on the feedback on psychology and credit demands of continued stringency in the supply of funds. Continuation of the present course of monetary policy for at least one more meeting--even in the face of a projected bank credit contraction in March--would contribute to this end. By spring the outlook is still for some decline in short-term interest rates when Treasury net debt repayment at last develops and as economic expansion continues to slow--at least as projected by the staff. Such developments, if they eventuate, would present an occasion for policy to permit somewhat less stringency in short-term markets, but with the relaxation

kept modest enough so as to minimize the risk of undoing progress toward reducing inflationary pressures.

Maintenance of the present course of policy until that time has some risks, however. Loan demands on banks could prove strong enough in March and around mid-April, when they will be bolstered by needs to meet tax payments, to force banks to bid even more actively for Euro-dollars or to undertake strenuous adjustments in their portfolio of longer-term securities, with resulting serious congestion in longer-term markets. Such a problem, if it should develop and threaten highly adverse psychological repercussions in all financial and goods and services markets, could be ameliorated in the short-run by additional System reserve provision, including purchases outside the Treasury bill area. This might be associated with a higher short-run money supply growth--and in any event the average level of the March money supply is expected to be well above the February average--but still total deposits are weak. Another alternative would be to bring other monetary instruments into play, as suggested by Mr. Brill, thereby permitting more of a flow of bank credit, though at higher interest costs. Whatever approach is taken, the negative bank credit projection for March suggests to me that there may be room for some additional reserve supply without leading to any significant resurgence of inflationary attitudes.

Mr. Solomon made the following statement on international financial developments:

At its last two meetings, the Committee has been given projections of the U.S. balance of payments for 1969--projections that show what we have called a tolerable outcome for the year. We have stressed that this outcome is dependent on certain conditions that are not likely to persist beyond 1969. Specifically, our imports will increase less this year than we would expect in a normal year of healthy non-inflationary growth. Our interest rates will be higher this year than we would expect year in and year out in the future. And the restraints on capital outflow--the IET and the Commerce and Federal Reserve programs--may be more stringent this year than can be expected in the future. We know that the Administration is very anxious to relax these controls and that a first step in this direction will probably be taken soon.

It may be useful to ask ourselves a number of questions regarding what we can expect of the U.S. balance of payments beyond 1969, when these special favorable factors may not be operative. We should also ask what sort of balance of payments we should aim at in the future. One purpose in asking these questions is to ascertain whether new policy initiatives will be required to cope with the balance of payments.

A major question concerns the trade surplus. Here several sub-questions arise. Have we lost significant competitiveness as a result of the price advances of the past three years? The relatively favorable performance of our exports seems to point to a negative answer, but our import performance seems to say yes, though here it is terribly difficult to separate price effects from income effects and from the effects of changing consumer tastes. We simply do not know how much the rate of growth of our imports will subside when aggregate demand returns to a normal rate of expansion. In particular, we do not know whether the growth of our exports will significantly exceed import growth when the economy resumes a non-inflationary rate of expansion and therefore whether the trade surplus will increase. We must certainly face the possibility that, when a normal rate of expansion resumes after the cooling-off period that we hope we are now entering, our trade surplus will look quite small as compared with what it was in the mid-1960's.

This in turn leads to another question. Given the recent ability of the United States to attract capital from Europe, should we perhaps content ourselves with a smaller trade surplus than we earlier thought we needed? Another way of asking this question is this: given what appear to be persistent large current account surpluses in Italy and Germany and given the need for the U.K. to achieve a substantial current account surplus, is it reasonable for the United States to expect to enlarge its current account very much? Not everyone can be above the average, and not everyone can be in current account surplus. If European investors continue to find American securities attractive--while at the same time the United States invests private and public capital in Europe and the less-developed countries--it might make sense for the United States to reconcile itself to a smaller net capital outflow and a smaller current account surplus than we earlier thought was appropriate. Such a balance of payments structure need not be incompatible with an ample flow of capital from all developed countries together to the less-developed world.

In considering these two possible balance of payments patterns--a smaller or a larger current account surplus--we must take account of the balance of payments aims of other countries and must assess our own ability to influence other countries' policies, in addition to asking what policies we must follow. For example, if we believe that, for a variety of reasons, the United States should have a substantial surplus on current account--as in the mid-1960's--we may have to consider policies that improve our international competitive position. Since we cannot expect to roll prices back, this inevitably faces us with the exchange rate question or, as a possible alternative, the border tax question. Yet we cannot determine our exchange rate unilaterally. Here again we run into the aims of other countries.

On the other hand, in assessing the viability of our balance of payments with a smaller trade surplus, we must ask what policies we would need to follow in order to assure a continuing capital inflow from Europe and a not excessive capital outflow from the United States. We are still unsure of the sustainability of the surge in 1968 of foreign purchases of U.S. stocks, even though, incidentally, the inflow rose to $300 million in the month of January. We also need to consider whether there are implications for future monetary policy in choosing to aim at a balance of payments structure with a small net capital outflow.

A related set of choices concerns the existing restraints on U.S. capital outflow. I would judge that the real costs of these restraints to the nation and to the world have up to now been rather small. And they have provided benefits by stimulating the development of an international capital market in Europe. Yet these measures are obviously irritating and odious to the business community. It is uncertain whether a substitution of market-oriented capital restraints--similar to the IET--for the present Federal Reserve and Commerce programs would be more palatable.

In any event if it turns out that the United States is unwilling for long to maintain Governmental restraints on private capital outflow, we are faced once again with adopting policies either to enlarge the current account or to attract even more foreign capital in this direction.

Up to now I have focused mainly on questions about the future structure of the U.S. balance of payments. We can ask still other questions regarding the over-all

balance of payments position of the United States and other countries. One problem that will hang over our heads for some time will be the large volume of Euro-dollar liabilities that we have incurred in the past three years. American banks owe about $9 billion to the Euro-dollar market through their branches. If interest rate relationships should change drastically as between the United States and Europe, we may face a flood of dollars out of private hands into the reserves of European countries. We might then be considering selective devices to induce U.S. banks to retain these funds as an alternative to tighter monetary policy than would be needed for domestic reasons.

Assuming we do not have to face the problem of a massive return flow of Euro-dollars and are able to maintain an official settlements balance of payments within a range of, say, plus or minus $1 billion, there is a real question whether the world can achieve a durable equilibrium without the early creation of SDR's. This is so because Britain must achieve a surplus on official settlements in order to repay debt, which will reduce other countries' reserves. Many countries inside and outside Europe normally gain reserves each year. Unless reserves are created, it is hard to avoid a situation in which the surpluses that countries aim for do not exceed the deficits that other countries are able and willing to sustain. This is the conclusion to which Working Party Three seems to be coming.

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

While recent developments in the economy have been by no means uniformly exuberant, there is still no conclusive evidence of a substantial and pervasive slowdown--although some moderation in the rate of advance seems likely to occur this year. Consumer spending seems to be the major area where slackening is visible, and this could lead to some need for inventory adjustment which could spread the effects of the weaker retail buying to other sectors. So far, however, whatever inventory excesses may have developed appear to be of modest proportions. There is no assurance that retail sales

will remain weak or that offsetting strength will not materialize from other sources. And we have made no progress so far on the price front, although the recent performance of the stock market suggests that inflationary psychology may be a shade less dominant than it was a few weeks ago.

The latest balance of payments projections look to a worsening of the over-all balance in 1969, with an expected improvement in the trade surplus likely to be more than offset by a deterioration of the capital balance. Of course, even the trade improvement that is projected depends largely on a visible dampening of the business expansion in the United States. The Euro-dollar market has become appreciably tighter under the influence of a reduced supply in the face of continued heavy demand from American banks. On the other hand, the supply is being replenished to some extent by our continuing heavy liquidity deficit and by some loss of central bank reserves. The exchange markets have been active, with the dollar generally strong.

Increasing monetary restraint and the sharp rise in market interest rates have produced a dramatic turn-around in bank credit and deposits. Such a turn-around, if not carried too far, can only be welcomed after last year's excessive credit expansion. The zero growth rate for the proxy--after adjustment for Euro-dollars--in January and February no doubt strikes most of us as quite appropriate. On the other hand, the March projection of a 3 to 6 per cent drop--even if highly tentative--may raise a question whether we may be pressing too hard. However, any worries over this projection should be tempered by two considerations. First, a temporary run-down of Treasury deposits will be one important cause of the March proxy decline, if there is one. Second, we are perhaps justified in being a little more skeptical than usual of the significance of the bank credit figures when disintermediation may be resulting in a substitution of other credit for bank credit, with perhaps little or no effect on the total. My own inclination would be not to be greatly disturbed by a negative figure in March unless it is accompanied by an excessive tightening of credit markets in general. I recognize, of course, that we would probably not like to see a repetition of such declines in bank credit for several months in a row.

As long as we seem to be getting very tangible results in the way of a slower expansion of the monetary aggregates, it seems to me that we would do well to hold to a steady policy, avoiding any changes that might suggest either a weakening of that policy or a ruthless disregard of the danger of a new credit crunch. With respect to open market targets over the next four weeks, I would suggest maintaining about the conditions that have developed since the last meeting, even though these are perhaps a shade firmer than we thought likely at that time. This would imply roughly a Federal funds rate around 6-1/2 to 6-3/4 per cent, member bank borrowings of $700 million to $1 billion, and net borrowed reserves around $500 million to $700 million. The three-month Treasury bill rate might fluctuate around a 6 to 6-1/4 per cent range under these conditions.

The staff's draft directive looks fine to me.[1/] In view of the importance of avoiding too abrupt a change in bank credit, I would favor keeping the two-way proviso clause, but I think its implementation could be a very delicate matter, closely bound up with market psychology. On the up side, there might well be considerable latitude for expansion--say a rate of increase in the proxy of 5 per cent--before the Manager implemented the proviso clause. On the down side, on the other hand, I would be prepared to see the proviso implemented if the lower end of the projected range seemed likely to be attained, particularly if this were accompanied by strong upward interest rate pressures. While advocating retention of the proviso, I would nevertheless urge that the working of the proviso clause should not be of such a magnitude as to change basic market expectations. In the event that a tendency toward a market tightness and excessive bank credit shrinkage were to persist despite modest use of the proviso clause, it might be well to consider some increase in the Regulation Q ceilings. Here again, however, there would be real risks that the increase in ceilings might be interpreted as a major easing of policy. Thus, the upward ceiling adjustment might well have to be accompanied or followed by an increase in the discount rate. All of these considerations are, of course, for the future rather than the present.

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

Mr. Morris recalled that at the past two meetings he had expressed concern that the transition being made to a restrictive policy might be too abrupt and severe for an economy in a decelerating phase, even though the pace of that deceleration was maddeningly slow. Happily, his fears had not been realized in January and February. Instead of a contraction in bank credit in those months, there had been a leveling off. The policy of restraint was being felt but, thus far, the change had been orderly and a panic response from the market had been avoided.

In January, Mr. Morris said, the new monetary policy had been cushioned appropriately through the Euro-dollar market. In February, the projection had simply missed the target on the high side in the closing days of the month. February was the first month since he had been on the Committee for which he considered the actual results to be superior to the staff's projections.

In Mr. Morris' judgment, the current flow of economic data did not yield a clear-cut picture of the pattern for 1969. In such a context, it was particularly important for the members to keep an open mind and to treat the economic projections with the skepticism that even the best of projections so richly deserved. He thought that if one looked at the economy in a Keynesian framework one had to be impressed by the divergent trends over the past six months between private consumption and

private investment. In his judgment, those divergent trends clearly could not be sustained beyond mid-year; if retail sales did not move up from the plateau they had been on since August 1968, one could expect business investment spending plans to be cut back in the latter part of 1969. He was not forecasting that such a sequence of events would in fact materialize, but he thought the Committee had to be alert to the possibility that private demand could be weaker in the last half of 1969 than current projections suggested.

Mr. Morris observed that the National Bureau's indicators provided a similarly indecisive picture of trends in the economy. He was happy to see that the staff had added to the green book[1/] a brief section on leading indicators. As the green book suggested, the leading indicators had tended to level off since October, but no real weakness had set in as yet. Equally significant to a dedicated National Bureau man was the very sharp rise in the lagging indicators, a development characteristic of the closing phase of a business expansion. Thus, the performance of the National Bureau indicators would be compatible with a forecast of a weaker economy in the second half even though it did not provide a firm basis for such a forecast at the moment.

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

Mr. Morris said he thought the Committee, in formulating monetary policy today, should give considerable weight to the fact that economic forecasting currently had more than the usual hazards, given the formlessness of the incoming data. In that uncertain economic context he would support a monetary policy which could be described as substantially but not severely restrictive, the language used by Chairman Martin in his recent testimony before the Joint Economic Committee. He thought the policy pursued in January and February had been of that character. One dimension of that restraint--not mentioned in the staff reports--was that there occurred a sharp resurgence of loans against insurance policies in the month of January. The Boston Reserve Bank's survey of ten large New England life insurance companies showed that policy loans rose by $33 million in the month of January, the largest monthly increase since 1966. That suggested a possible trend toward higher loans which would soon be reflected in reductions in the liquidity of insurance companies.

Mr. Morris felt that the policy of restraint of the past few months had put a dent in inflationary expectations, as the stock market decline indicated, but had not yet shattered those expectations. By and large, professional investors appeared to have moved to the sidelines; they were not buying stocks but neither were they engaged in massive selling, which suggested that their confidence had not been severely weakened. The only

net buyers of stocks recently seemed to be the odd-lotters, and of course they were always the last to get the word. In sum, he thought progress was being made in eroding inflationary expectations.

In establishing a policy for March, Mr. Morris said, the Committee had to give weight to the fact that monetary restraint was certain to bite more sharply than in January and February because the easy adjustment mechanisms available to banks had been largely used up. Future adjustments would be more painful. In that context, there arose the question of how to define a bank credit proviso so as to produce substantial but not severe restraint. Clearly, that was a matter of judgment rather than scientific calculation. His own judgment would be that the Committee should aim for a less restrictive bank credit target than the 3 to 6 per cent rate of decline projected for March. His preference would be for a one-way proviso guarding against downward deviations from the projection. However, he could accept the draft two-way proviso if it was interpreted in the manner suggested by Mr. Hayes, which seemed to amount to about the same thing.

Mr. Coldwell observed that economic activity in the Eleventh District was still at a high level. Industrial production was down slightly but employment was stronger than seasonal. Unemployment was at minimal levels, especially in the large

cities. For example, the unemployment rate in Dallas was now 1.1 per cent, which meant in effect that workers were not available. The evidence suggested that retail trade was still strong in the area. Price increases affecting a very wide range of goods and services were becoming a number one topic of conversation and were impressive by any recent standards.

Mr. Coldwell said that bank loan demands in the District were very strong, especially business loans. The liquidity of some banks was declining, but borrowings through CD's and from the Reserve Bank and recourse sales of loans and securities were providing funds to large banks, while country banks generally were in excess reserve positions. Borrowings from the Dallas Reserve Bank had doubled over the past four weeks. In addition, District banks had sharply increased their daily net purchases of Federal funds.

Mr. Coldwell reported that a survey taken last week of 14 large savings and loan associations with about $1-1/2 billion of savings showed a savings inflow of $3.3 million since the end of 1968. Of the 14 associations, five indicated that their savings inflows were substantially less than a year earlier. Similarly, five said their current volume of new commitments was below a year ago, with three indicating that the level was substantially lower. Nevertheless, the associations seemed to be in much better shape than in 1966, and despite some slowness of

savings inflows they were more troubled by the possible future impact of high interest rates than by their current situations.

Turning to national conditions, Mr. Coldwell remarked that while modest progress had been made in slowing the economy that progress was insufficient. Capital spending was still advancing, consumers were still fundamentally optimistic, and speculative activity was very strong, especially in real estate. Wages, costs, and prices were going up rapidly. Strong inflationary expectations were still forming the basis for business and consumer spending decisions. It seemed to him that before concluding from recent data that the economy was cooling off, one should take account of the various temporary factors that had had adverse effects on consumer spending, production, overtime worked, and earnings. Those factors included the influenza epidemic, bad weather, strikes, and transportation tie-ups. In his judgment there was a distinct possibility of a rebound in activity in the spring.

With regard to financial developments, Mr. Coldwell observed that the margins of available funds at banks were narrowing, but in the main they were basically adequate to meet even strong business loan demand. Pressure on reserves was being accommodated by reducing liquidity or by borrowing. Activity was at advanced levels with respect to Euro-dollars, Federal funds, and discounting. In addition, larger banks were selling

securities on a repurchase basis and selling participations in loans to country banks. However, the pressures on banks had not been sufficiently great to cause major changes in lending policies. Loans were being made to bank customers even for speculative purposes.

Mr. Coldwell believed that while progress had been made under recent monetary policy, businessmen still had not been convinced that inflation would not bail them out of rising costs. As a result, wages and prices continued to rise. What was needed was further visible evidence of monetary restraint, but in moderate proportions. He favored an increase of 1/4 percentage point in the discount rate, partly because it would represent a moderate action and partly because the current rate was out of line with the market and might be encouraging borrowing. A discount rate increase also would give recognition to the fact that the market was leading the way toward higher interest rates. As a visible move, it would strengthen convictions that the System was committed to restraint and it might convince some speculators and others that inflation at an increasing pace was not inevitable.

In sum, Mr. Coldwell said, he would recommend a 1/4 percentage point increase in discount rates with supporting open market action to further restrain the economy in a moderate, steady, and slowly increasing fashion. To implement such an open

market policy, targets at the upper end of the ranges given in the blue book[1] would seem acceptable. He could support the directive as drafted, except that he would propose a clarifying addition to the statement on bank credit in the first paragraph. Specifically, he suggested amending the statement to read: "In the first two months of the year bank credit changed little on average, as investments contracted while loan demands, especially from businesses, remained strong." The remainder of the sentence shown in the draft would then be included as a separate sentence.

Mr. Swan reported that the unemployment rate in the Pacific Coast states had turned out to be the same in January as in December--4.2 per cent--despite the increase in unemployment insurance claims that he had noted at the last meeting. Such claims had continued to rise in the first two weeks of February. There was a sharp drop in housing starts in the West in January which undoubtedly was related to bad weather. The weather also limited lumbering activity and contributed to the recent soaring of lumber prices.

District banks were coming under some pressure, Mr. Swan continued. Borrowings from the Reserve Bank had risen, especially

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1/ The blue book passage referred to read as follows: "A 3-month bill in a 6-6.25 per cent range might be consistent with a Federal funds rate averaging in a 6-3/8 - 6-5/8 per cent range, with member bank borrowings in a $700 - $900 million range, and net borrowed reserves in a $500 - $700 million range."

in the last two weeks. Paradoxically, District banks as a group remained net sellers of Federal funds, but that was entirely due to the position of one large District bank; the other banks were net purchasers. He had found support in recent conversations with bankers for the conclusions of the Bank Lending Practices Survey; banker attitudes toward monetary restraint were finally beginning to change and bankers were becoming somewhat concerned about their ability to meet prospective business loan demands. A check with the Reserve Bank's sample of five large California savings and loan associations indicated some increase in savings accounts in February, but if the sample were blown up to a total the rise for the month apparently would be somewhat less than in February 1968.

Turning to policy, Mr. Swan said he shared some of the concerns expressed about the projected decline in the bank credit proxy in March, but he hoped the Committee could avoid an overt policy change in either direction at this time. Mr. Brill had proposed an interesting package of policy measures which could result in somewhat higher interest rates and some expansion in the availability of funds. However, he (Mr. Swan) hoped it would prove possible to get through the next few weeks without taking such measures, since they could lead to the provision of somewhat more funds to the market than was desirable. While he would prefer a slightly different course for bank credit in March than

that projected, he would not object to another month of leveling off or modest decrease and he would not like to see market conditions eased in order to achieve an upturn.

In terms of his policy prescription, Mr. Swan remarked, he came out about where Messrs. Hayes and Morris had. He could accept the draft directive, but he would advocate an asymmetrical interpretation of the two-way proviso under which the Manager would be instructed to modify operations promptly if bank credit was approaching the lower limit of the projected range, whereas no action would be called for on the upside unless there was a significant deviation above the upper limit.

Mr. Galusha said he was happy to report that the end of nonpar banking in the Ninth District was now definitely in sight, as the result of several years of effort. A few days ago, the Governor of North Dakota--the last of the District's nonpar states--had signed a bill making par clearance mandatory as of July 1, 1971.

There was some evidence that the Ninth District economy was presently growing a little less rapidly than earlier, Mr. Galusha continued. Also, according to the Reserve Bank's most recent survey, District manufacturers were now a shade less optimistic than before; sales were up 12 per cent, year-over-year, in the previous quarter and the expectation was for a 9 per cent increase in the current quarter.

Surprisingly perhaps, Mr. Galusha added, the District's construction industry was continuing on its merry way, although for how long was anybody's guess. Construction employment was up sharply in January; so too was the total of building permits. Loan commitments of savings and loan associations had also increased, if slightly, despite a more-than-seasonal decrease in total liabilities.

Among District weekly reporting banks, Mr. Galusha said, the decrease in large-denomination CD liabilities had been considerable: in January it was 50 per cent of the dollar total of maturing certificates, and in February 40 per cent. The decreases should be about as great in March and April as in February, and some of the District's largest banks, who were well aware of that, were clearly concerned. The Reserve Bank had already had several requests for rather large loans. So far the Bank's policy had been to lend smaller-than-requested sums and to encourage borrowing banks to limit business loans. After a considerable search, the Bank had found one instance of a manufacturer postponing an expansion plan because of distasteful loan conditions. One swallow did not make a spring, but as the end of winter approached in Minneapolis one got his comfort where he could.

Mr. Galusha noted incidentally that a few of the District's country banks had reported outlying counties and school districts

switching from time deposits to Treasury securities. The rates of growth of country bank total assets and time liabilities had decreased somewhat. But compared with city banks, country banks were still in a relatively comfortable position.

As to Committee policy, Mr. Galusha said he had to confess to getting a little nervous every time he compared bank credit and money supply growth rates for November-December 1968 with those for January-February 1969. Whatever might be said, the System had not "steadily and gradually" increased monetary restraint. Very soon its critics surely would again be decrying the System's erratic behavior. Nor was it clear how misguided such criticism would be. But the Committee perhaps could delay a while longer before attempting to force slight increases in the rates of growth of bank credit and certain other monetary aggregates. It could delay briefly and still be roughly on the course charted for it by Mr. Brill and his associates at the Committee's last meeting.

The danger of delaying was clear, Mr. Galusha remarked. Yet it was extremely important that the outlook be for relatively modest increases in nominal GNP, not just in the first half of 1969 but in the second half as well. A bearish medium-term outlook was required to change inflationary expectations.

This morning, then, Mr. Galusha said, he was for no change in Committee policy. He accepted as reasonable the monetary targets

given in the blue book. He was for the staff directive as drafted and again favored a two-way proviso clause.

Mr. Galusha observed that he had perhaps already made clear, by implication, how he felt about changing reserve requirements and discount rates. To be explicit, however, he favored leaving reserve requirements as they were, at least for now; and increasing discount rates, if at all, only after the prime rate had been increased again. Finally, he favored leaving Regulation Q ceiling rates unchanged. He granted, however, that increasing ceiling rates for large-denomination CD's might soon be necessary, if only to force a modest increase in rates of growth of certain monetary aggregates--such as, for example, bank credit.

Mr. Scanlon reported that the general economic picture in the Seventh District continued basically unchanged. There was some evidence of easier demand, especially for consumer durables, and, hopefully, that would continue until there was some easing of pressure on labor markets. In most major District centers, labor markets appeared to have tightened further. In the Gary-Hammond area, two important steel companies had begun to hire women for production jobs, a development reminiscent of World War II.

Mr. Scanlon noted that price increases had been reported much more frequently in January and February than a year ago, and they applied to a wide range of both hard and soft goods. A larger

proportion of the purchasing agents in Chicago recently had reported increases in prices paid and in production, employment, inventories, and new orders. They had indicated slower deliveries from suppliers and more frequent complaints of quality-defective goods--reflecting labor shortages or other production problems. While the buildup of inventories might be somewhat on the excessive side insofar as some consumer durables were concerned, his contacts with Midwest businessmen revealed that many found their inventories low by past standards--so low as to hamper production in some cases.

February auto sales had relaxed some of the uneasiness that had been evident in that industry, Mr. Scanlon said. A rise in spending for new and used producer equipment appeared to have gathered momentum, demand for construction equipment was up from last year, and some manufacturers reported at least a temporary pick-up in sales of farm equipment. The demand for construction equipment apparently had strengthened in both domestic and foreign markets. Orders for railroad equipment had increased sharply. Shipments of heavy trucks and trailers were very strong. Orders for components of capital goods--such as drives, bearings, and gears--had spurted since last fall. Steel orders continued to be better than expected, with a favorable order book now building for March and April. Orders had increased "across-the-board."

Mortgage funds, of course, were extremely tight, Mr. Scanlon continued. Insurance companies had almost ceased to grant single-family mortgages in the District and had largely withdrawn from the farm mortgage market in states having usury laws of 7 per cent or less. Policy loans had risen again. The shift in housing permits to multiple unit structures, with lenders commonly taking an equity interest, had continued.

Mr. Scanlon commented that loan demand at District banks appeared to have strengthened in recent weeks. Nearly all of the District's large banks in the Lending Practices Survey reported business loan demand either moderately or greatly stronger than three months ago and they expected that situation to continue during the quarter ahead. The recent growth in business loans had not been so fast as in 1966, however. The banks reported they were screening out borrowers who were not their best customers, and most of them reported that they were refusing certain types of loans, charging more for the less desirable credits, and generally rationing available funds. Some of them indicated less willingness to make term loans and mortgages, but only in one case did that reluctance extend to consumer loans. The current Survey produced an unusually large number of comments to the effect that the demand bankers saw was larger than they could accommodate with present prospects for deposit growth, and there was a good deal of evidence

of increasingly restrictive loan policies. The weekly condition reports showed that real estate and consumer loans had continued to expand moderately thus far.

Mr. Scanlon observed that liquidation of Governments had continued as the further run-off of CD's had been only partially offset by Euro-dollar borrowings. The large banks had not made much use of the discount window, but the number of smaller borrowers had been rising. The number of penalties assessed for reserve deficiencies had been substantially larger than before the change in Regulation D, probably because of the one-week reserve period. While banks could reduce liquidity somewhat further, continued strong credit demands would indicate either some stringent rationing of credit or more business for the discount window.

As to policy, Mr. Scanlon believed that the Committee should maintain a posture of persistent firmness at this point. He would prefer slow and steady rates of monetary and credit expansion. He was not sure that that could be achieved within the existing framework of ceilings on CD's because of the sizable changes that tended to be associated with fairly small shifts in bill rates above or below the Q ceilings. Furthermore, the annual report of the Manager of the Open Market Account indicated rather impressively that the Committee had not been able to find a close and meaningful linkage between money market conditions and the rate

of growth of bank credit, which suggested that interest rates probably would have to be relegated to a position of less importance in the Committee's instructions to the Manager. In turn, that placed a high priority on the work with respect to the directive that had recently been undertaken by Messrs. Maisel, Morris, and Swan.

Within the framework of the staff's projections of bank credit and money for the first half of 1969, it appeared to Mr. Scanlon that fairly substantial rates of expansion were contemplated in the second quarter to achieve the projected rates for the first half. He would prefer that such changes be fairly gradual, if that could be achieved.

The draft directive was acceptable to Mr. Scanlon.

Mr. Clay commented that price inflation remained the principal economic problem in this country. Thus far there had been little evidence of improvement in the price inflation situation. In addition to the continuing price increases, there was a disturbing pattern of large wage settlements that would affect cost-price expectations and developments ahead.

Business spending and business spending plans were indications of strong expansionary forces at work, Mr. Clay said, and there was reason to believe that production cost increases and price inflation expectations constituted

important factors in those decisions. Employment and unemployment data further underscored the pressures on the economy, and the increases in industrial production reflected the expansionary tendencies.

The most significant development on the encouraging side, Mr. Clay noted, was the slower pace of consumer spending, which was so important a segment of the national economy. Many had interpreted that as a forerunner of a readjustment in business investment in both inventories and fixed capital outlays and a lessening of pressure on resources and prices generally. While that sequence of developments might materialize, it had to be recognized that such a course of events was by no means assured.

Mr. Clay thought it would be necessary to keep the pressure of monetary restraint on the economy. He said that with an awareness of the time lag for the full impact of monetary actions. However, that view also was predicated on a judgment that the price inflationary forces and expectations were probably much stronger and less responsive to restraint than might be generally assumed. Error on the side of relaxation or inadequate restraint would simply take the economy on yet another round of accelerating cost-price inflation.

Mr. Clay said the shift in policy to a more restrictive posture had brought substantial response in financial variables

and probably in the public's understanding of the Federal Reserve's determination to pursue such a policy. It was too soon to know what the impact would be on economic activity and prices. Continuation of present policy presumably would have further financial effects, and it might be that it would lead to more financial stringency than was consistent with longer-term objectives. For the present, however, it would seem appropriate to continue monetary policy essentially unchanged. In view of the staff projection for bank credit, it would be well to tolerate a smaller deviation on the down-side than on the upside before implementing the bank credit proviso. The blue book statement of monetary variables most likely to be associated with a continuation of current policy appeared reasonable.

The draft directive appeared to Mr. Clay to be satisfactory.

Mr. Heflin reported that business in the Fifth District continued strong, with signs of some deceleration in the rate of advance centering mainly in the consumer and residential construction sectors. The Richmond Reserve Bank's optimism index suggested that District businessmen remained essentially bullish on the future.

At the national level, the recent rash of price increases was disturbing to Mr. Heflin, although in the perspective of last

year's wage contracts and credit expansion, he thought some further markups had to be expected in the months ahead. Of greater concern for the near-term future was the growing evidence that business investment outlays might be out of line with the current pace of expansion in final demand. While he was not yet convinced that the System had succeeded in bringing over-all expansion under control, he believed that it now had substantive evidence of a significant moderation in demand in the consumer and Government sectors. Signs of continued exuberance in the economy appeared to be increasingly concentrated in the business investment sector.

Mr. Heflin remarked that the recent stock market slide might, of course, have some implications for future business plans. The decline had now assumed a magnitude that involved a substantial wealth effect and could well be interpreted as an additional sign of developing moderation in the pace of business. Apart from that, its psychological impact was almost certain to be in the right direction from the standpoint of the System's objectives. That was all the more the case in view of the fact that the latest break seemed to be related to a growing market conviction that the System was dead serious about tight money.

Mr. Heflin noted that credit markets had remained tight since the Committee's last meeting and were likely to

become even tighter over the next four weeks. The economy was now moving into a period of fairly heavy seasonal demands for credit, at a time when CD run-offs were continuing and the large banks were experiencing greater difficulty in finding Euro-dollar accommodation. He was not at all sure that the full market impact of last week's bank rate increases in Europe and Canada had been seen. Nor was he sure that markets had fully discounted the rumored hike in the prime rate.

In the policy area, Mr. Heflin thought the Committee's posture since the December discount rate increase had been about right and had produced altogether wholesome results. In view of the magnitude of the task the System confronted, he believed it would be a mistake to give the market any suggestion that it was backing away from that posture. While he would be concerned by any sustained decline in bank credit, he believed that for the present the directive was satisfactory as drafted, with the proviso clause to be interpreted in the manner suggested by Mr. Hayes. He would hold in reserve the package of measures Mr. Brill had outlined, including a discount rate change, for possible use if future circumstances suggested a need for stronger medicine.

Mr. Mitchell remarked that some of the banking system's liquidity was being absorbed under the monetary policy that had

been followed since mid-December, and the necessary amount of monetary restraint was probably already in train. At present the main need was to maintain a posture that, on the one hand, would not dispel the psychological effects that had been achieved and, on the other hand, would not bear down too heavily, given the lagged effects of monetary policy actions.

However, Mr. Mitchell continued, the System might soon encounter serious difficulties if it tried to rely on the present combination of policy instruments. The effects of the recent monetary restraint had been greater in some areas than in others, and if the System continued to rely on the same tools it was likely to create a crunch. In his judgment, it probably would be desirable in the interval before the next meeting of the Committee to take the kinds of policy actions Mr. Brill had outlined today. He would prefer to have the System take such actions on its own initiative, rather than wait until it was forced to do so by persisting declines in bank liquidity. However, he was not prepared to advocate immediate action along those lines. Accordingly, he planned to vote today for a directive along the lines of the staff draft.

Mr. Daane commented that under its present policy the System was walking on ice--a not impossible act, but one that required great care. The complexities of the situation the

System faced were illustrated by the conflicting kinds of comments he had heard recently from knowledgeable market observers. Some had told him in the past week that while they thought present monetary policy was correct, that policy was being undercut by the assurances System officials had offered that a crunch would be avoided--assurances which, in their judgment, had led bankers to take a more accommodative attitude toward borrowers than they would have otherwise. Others had told him that they thought a crunch--however they defined the term--already existed, and had expressed the hope that the System would not take any regulatory action to limit U.S. bank access to the Euro-dollar market, which they considered an important safety valve. In their opinion the scarcity and high cost of Euro-dollar funds by themselves were adequate to constrain bank use of that source of funds.

For his own part, Mr. Daane said, he did not think the System's current policy had been vitiated by assurances that a crunch would be avoided, and he favored continuing that policy. At the same time, he thought it would be important to avoid any suggestion that the System was backing away from the existing degree of restraint. For that reason, he would be highly reluctant to raise the Regulation Q ceilings at this juncture.

More generally, Mr. Daane continued, he was not persuaded that the package of actions Mr. Brill had described would be

appropriate in the near term, and he certainly would not want to take such actions immediately. He had some sympathy with the view that a discount rate above the present level would be logical, but he would not want to take the overt step of raising the rate--especially not prior to an increase in the prime rate.

Mr. Daane said the draft directive was acceptable to him. With respect to the proviso clause, he was less concerned than some others who had spoken about the risk of downward deviations of bank credit from the projection, particularly in view of the recent tendency toward upward revisions in the estimates of the proxy series.

Mr. Maisel remarked that the Committee faced two critical questions at this time. The first concerned the appropriate rate of growth of bank credit, and the second concerned the appropriate means for achieving the desired growth rate. In his judgment the decline in bank credit projected for March was not desirable, and accordingly he would favor either the one-way proviso Mr. Morris had proposed or a two-way proviso interpreted asymmetrically as Mr. Hayes had suggested. In operating under the proviso, however, it would be important for the Desk to look ahead to the probable behavior of bank credit after March. A situation in which the absence of growth in March was associated with an expected decline in April would have an entirely different significance from one in which expansion in April was anticipated.

If action to stimulate bank credit growth were required, Mr. Maisel continued, the System would have to face the problem of its effects on market expectations. The choice presumably would be between supplying additional reserves through open market operations or raising the Regulation Q ceilings. In his judgment it would be preferable to rely on open market operations for the purpose; to increase the Q ceilings would be to lose control to an important extent, whereas open market operations could be controlled closely. Accordingly, he thought the Desk should stand ready to furnish reserves at the margin, particularly since, as Mr. Hayes had pointed out, money market conditions currently were slightly firmer than had been anticipated. He thought Mr. Hickman's point was well taken that it might be desirable to rely on public statements to avoid undesirable psychological reactions to the data that might be published. Certainly, it would be better to follow such a procedure than to stay with an improper policy because of fears that a change would have unwanted effects on psychology.

Mr. Brimmer observed that he could accept the staff's draft directive as written, although he had no objection to the change in the first paragraph that Mr. Coldwell had suggested. The Committee might also want to make a small additional change, in the sentence regarding the balance of payments. That sentence

would be clearer, he thought, if the words "and a deficit also reappeared" were added at the beginning of the final clause. As to the second paragraph, he favored retaining the two-way proviso shown in the staff's draft.

With respect to policy, Mr. Brimmer said he was convinced that quite a few banks were counting on the Federal Reserve to supply them with funds so that they would not have to deny any loans their good customers might want. It was important that the System avoid doing so. In his judgment it would be a serious error to raise Regulation Q ceilings at this time. When the ceilings had been raised in 1965 and on large-denomination CD's in 1968 the large banks had rapidly built up the volume of CD's outstanding and had thus been able to expand their business loans and other earning assets at undesirable rates. The Manager should have authority to buy coupon issues if heavy selling by banks threatened to produce disorderly market conditions. As Mr. Maisel had suggested, however, it would be undesirable for the System to give up control by raising the Q ceilings. As to discount rates, that question would be faced by the Board as advices were received of actions by the Reserve Bank directors.

Mr. Brimmer went on to say that he was disturbed by the recent inflows of Euro-dollars. The contrast to which Mr. Galusha had referred between rates of bank credit growth in the last two

months of 1968 and the first two months of 1969 was less striking if one considered the proxy series adjusted for Euro-dollar inflows. In addition, it was his impression that the recent tendency toward upward revisions in that proxy series had been associated to a large extent with underestimates of such inflows. If the System were to take the view that access to the Euro-dollar market offered a useful safety valve for some large banks it should still be concerned with the effects of the inflows on the course of aggregate bank credit. Personally, he had been concerned for some time with the fact that the effects of Euro-dollar inflows on U.S. bank credit were far from neutral.

In a concluding remark, Mr. Brimmer referred to Mr. Solomon's observation that the Administration was anxious to relax the restraints on capital outflows. It was important to keep in mind that if the Administration decided to provide additional leeway under the Commerce Department or Federal Reserve programs, the difficulties facing the Open Market Committee would be increased considerably.

Mr. Sherrill said he had come to believe that the momentum of inflation was even greater, and that it was likely to take a longer time to bring it under control, than he had thought earlier. For that reason, he believed the monetary conditions likely to be required might be harder on all participants than had been hoped. It was important that the System avoid creating the impression that

the banks would not have difficult adjustments to make. Partly for that reason, there was some risk of a crunch, which he would define as a situation in which banks sold securities at such a rate that the System would have to step in, buying securities and creating the liquidity for others to do so also. A shift from a pattern of continuing moderate sales of securities by banks to large-scale dumping could develop suddenly, offering the System very little time to react; accordingly, it was necessary for the System to be prepared to act quickly. Hopefully, it would be possible to get through the coming period without such developments occurring.

Mr. Sherrill favored the staff's draft of the directive, with the two-way proviso clause to be interpreted in the manner Mr. Hayes had suggested in order to minimize the risk of a crunch by providing for prompt action on the downside. If significantly easier money market conditions were found to be required under the proviso clause, he thought the System should instead take actions along the lines of those Mr. Brill had discussed. Actions of that type might well prove necessary before the next meeting of the Committee.

Mr. Hickman remarked that economic activity had shown a mixed pattern thus far in the first quarter. Consumer spending had slowed and would probably remain sluggish through the tax-payment

period. That would ultimately be reflected in a leveling off in industrial production as inventories of consumer goods were brought in line with sales. Investment spending was also likely to slow, along with residential construction, which should soon respond to the growing stringency of mortgage credit. On the other hand, construction activity was still strong, and conditions in the labor market remained extremely tight. Rapid increases in prices through February, and expectations of further price increases, indicated that the problem of inflation was far from being solved. While his staff did anticipate near-term moderation in the rate of gain in over-all prices, that would be due entirely to relief in food prices; the index of wholesale industrial prices and prices of nonfood consumer goods and services were still under strong upward pressure.

In recent weeks, Mr. Hickman said, most of the monetary and credit aggregates had moved slightly beyond the upper end of the ranges specified at the last meeting of the Committee. Although short-term bill rates moved lower until last week, primarily as a result of strong demand and short supply, CD rates were still not competitive with bill rates. Banks were continuing to experience a run-off of CD's, albeit at a reduced pace due to the smaller volume of maturities coming due. The CD run-off had served the useful purpose of reducing bank liquidity and had indicated to the

market that the System was serious in its efforts to control inflation, but the degree of restraint associated with that CD run-off was not an acceptable goal if continued indefinitely. Bank liquidity had already been reduced sharply, and the net flow of funds from the Euro-dollar market was shrinking, making it more difficult for banks to offset CD losses. Moreover, further run-offs of CD's could lead to substantial bank selling of municipal and Government securities, with additional upward pressure on yields.

In Mr. Hickman's opinion a decline in the credit proxy at an annual rate of 4 to 7 per cent as projected by the staff for March was not consistent with the policy of moderate, but steady, restraint stressed by the Chairman in his recent testimony before the Joint Economic Committee. He would recommend that the Committee shift to a policy of less restraint and seek to encourage moderate growth in the credit proxy, say in the order of 3 to 5 per cent, at an annual rate. To achieve that, he would favor a bill rate below the range specified by the staff in connection with the draft directive; specifically, he favored a 91-day bill rate in the range of 5.85 to 6.0 per cent. Moderately lower bill rates would temper the run-off of CD's, reduce the pressure on Euro-dollars, moderate bank selling into the securities markets, and perhaps avoid another increase in the prime rate.

Mr. Bopp said that like most observers he found it much harder to foresee the state of the economy after midyear than over

the next few months. The difficulties were compounded because real and financial indicators were giving conflicting signals. The outlook which the Philadelphia Bank's staff projected for the next few months differed somewhat from that given in the green book. His staff's projection called for more strength both in residential construction and business outlays for fixed investment, while their estimates of consumption spending in the second quarter were somewhat less than those of the Board's staff. However, the combination of higher plant and equipment outlays, residential construction, and Government spending resulted in a substantially smaller decline in inventory accumulation. Thus, while the Philadelphia Bank saw the rate of growth as moving in the direction of further moderation, they saw a stronger quarter than that envisaged by the Board's staff.

Mr. Bopp remarked that reports for the Third District confirmed the outlook for too much near-term strength. A recent spot check had turned up no evidence that large firms believed inventories were excessive compared with either present or expected sales. A larger sampling of Third District firms showed that businessmen were optimistic about the six-month outlook. Only one company had cut back on capital spending plans since the McGraw-Hill survey last fall. Most had accelerated capital spending in anticipation of higher prices and rising labor costs, with three out of five anticipating rising levels of general business activity.

If signs of restraint were few in the real sector of the economy, Mr. Bopp continued, that was not so in the financial sector. Last year's rapid rates of growth in the credit proxy had disappeared in only two months. The forecast was for further curtailment in March. Growth in the money supply had slowed sharply and the projected bulge in March was expected to be only temporary. Even without more restraint, revised expectations of the Federal budget surplus and Treasury cash needs and a likely step-up in the rate at which banks liquidated securities in response to expected loan demand would contribute to continued pressure on money market rates.

In short, Mr. Bopp said, restraint was clearly visible in the financial sector, but much less apparent in the real sector. In view of the lags that were apparently at work, there was reason for some concern that further reductions in the volume of bank credit could have an excessive impact on the economy later in the year. Since current signs of economic strength were sufficiently widespread, restraint still was the appropriate course. The costs--domestic and international--of fueling continued inflation were too high. But the potential costs in terms of income and employment of sudden and excessive restraint were also sufficiently high for the projection for bank credit in March, on top of the experience in January and February, to be disturbing.

Therefore, Mr. Bopp thought the Desk should resist contractions in bank credit during the next four weeks. The problem, of course, was how to do that without creating the wrong impression. The System, quite correctly, had been trying to convey the idea that policy was directed toward gradual and persistent restraint. It would be a mistake to undo the progress made in fostering that psychology. Yet it would also be a mistake to push restraint too far. Hopefully, given prevailing expectations for higher rates, the Desk could let up on the brake somewhat without precipitating undue effects in the money market. The two-way proviso seemed appropriate, with toleration of smaller deviations on the downside than on the upside.

Mr. Kimbrel commented that he presently found it especially difficult to sort out what bankers in the Sixth District were actually doing from what they reported they were doing. More District bankers were now saying that monetary policy was restricting their operations. He had reported at the last meeting that not a single banker had complained to him about monetary tightness. Since then, some bankers had visited the Reserve Bank to pave the way for a possibly greater use of the discount window in the future. Some bankers had told him that they were turning down loan applications from national accounts even at the risk of losing substantial deposit accounts. The results of the Atlanta Bank's Lending

Practices Survey were similar to those reported for the nation, with slightly stronger business loan demand expected by bankers for the next three months. Bankers were saying that if policy had not begun to bite already it was about to do so.

However, Mr. Kimbrel continued, there seemed to be a difference between what bankers were saying and what the figures indicated they were doing. If they were beginning to say "no" to loan applications, they were not doing it often enough to show up in the figures. In January loans declined at the smaller banks, on a seasonally adjusted basis, and the pace of loan growth fell off at the large banks. However, large District banks reported a considerable increase in total loans in the first three weeks of February, and the smaller banks reported an upsurge in loans during the first two weeks of the month. Some District banks, like those in the money market centers, had had to reduce investments, increase their borrowings, and make greater use of Federal funds in order to meet loan demands. District banks as a group had become net buyers of Federal funds, whereas they had customarily been net sellers. However, those adjustments had been much more limited than in 1966.

The figures suggested to Mr. Kimbrel that, although policy might have begun to bite, it had not bitten very deeply so far as Sixth District banks were concerned. Smaller District banks had

largely escaped the restraint, and what those at the larger banks were saying reflected more their worry about the future than their present actions. That might fit into the desired policy of "gradualism." He certainly would not like to see the conditions of 1966 repeated, but at the same time he believed the System should be sure there was some bite to gradualism.

Mr. Kimbrel said he had been a little fearful that a continued decline in the credit proxy at the January rate and the rate originally projected for February might be too strong medicine for a policy of gradually applying restraint. Recent developments, however, suggested that that might not be the case. Under those circumstances, if the set of money market indicators outlined in the blue book was likely to produce a decline in the credit proxy in March at the magnitude suggested, he would leave policy about as it was.

It might be that the System could not delay some action on the discount rate much longer, Mr. Kimbrel observed. However, he had reservations about the desirability of such action because of the difficulty of having it properly interpreted by the public and by the banking sector. Personally, he disliked giving banks a rationalization for a prime rate increase, but with member bank borrowing expanding and short-term rates as high as they were, raising the rate did have some logic. He would also hope the

System could delay any increase in Regulation Q ceilings for the time being.

In his own District, Mr. Kimbrel continued, smaller banks had been largely untouched by monetary restraint. A firm enough open market policy might eventually reach them, but he was inclined to think that an increase in reserve requirements would beneficially speed the process.

Under those conditions, Mr. Kimbrel concluded, his choice would be to accept the directive as drafted.

Mr. Francis said it seemed to him that the Committee and the Board had earnestly desired and attempted since December to turn in the direction of exercising restraint on total demand and thereby on inflation. Whether the policy had succeeded seemed to him a moot question.

Mr. Francis noted that the condition of the commercial banks had become increasingly strained. That development had followed from the disintermediation resulting from market interest rates rising relative to Regulation Q ceilings and from increasing credit demand. The squeeze on the commercial banks imposed by the bite of Regulation Q was no more evidence that the System was exercising general restraint on the economy than the great surge of bank credit at a 14 per cent annual rate in the third and fourth quarters of 1968 had been evidence of a great burst of ease, or

the deceleration of growth of total bank credit in early 1968 had been evidence of effective policy tightening. The effects of Regulation Q upon bank credit in recent years had destroyed whatever value that magnitude might ever have had as a target and means of monetary control.

Market interest rates were high, Mr. Francis continued, but that also was not good evidence that the System had succeeded in exercising restraint in the last two and a half months. The main rise of rates had occurred between August and mid-December, a period when the Committee had decided on relative ease. The rise of general interest rates after late August and the high present level had resulted from the tremendous demand for loan funds rather than from restraint on supply.

Mr. Francis noted that average borrowings from the Federal Reserve had risen by about $500 million since early December. That was evidence that member banks were under great stress as a result of the huge demands put on them and the deprivation of funds to them under the workings of Regulation Q. It was not evidence of Federal Reserve restraint on total credit or on total spending.

The figures with respect to the narrowly measured money supply had recently been greatly affected by the exceptionally large volume of Treasury deposits in the commercial banks,

Mr. Francis said. On only two other occasions in four years had those deposits been so high. When one made an adjustment for those extraordinary Treasury deposits, one found that the money supply had increased at a 5.9 per cent annual rate in the last three months. In view of the continued rapid expansion of the monetary base and total member bank reserves in the last three months, there was little basis for confidence in recent, current, or imminent deceleration of growth of the money supply. The monetary base had gone up at a 6.4 per cent rate, about the same as the 6.2 per cent rate of the preceding two years. Member bank reserves had risen at an 11 per cent rate in the latest three-month period compared with an 8 per cent rate in the previous two years.

Despite the System's firm intentions, Mr. Francis remarked, he could not find evidence in those data that it had begun to exercise monetary restraint. In his opinion the only way the Committee could assure itself that its desire for monetary restraint would be implemented would be to direct the Desk to produce growth of Federal Reserve credit, member bank reserves, and the monetary base at rates about half those of the past year. That should be significant and effective, though not nearly so extreme as in the period from April 1966 to January 1967 when the money supply did not increase at all.

At the same time that the System seemed to be failing to achieve general restraint, Mr. Francis remarked, the commercial banks--due to the high market interest rates which followed from the high inflation-stimulated demand for funds--were being severely wrenched with harmful results and to no good end. Although Regulation Q was not a responsibility of this Committee, he felt impelled to comment on it here, since its effects might play a significant role in open market policies. If the System should continue to force disintermediation on the commercial banks through Regulation Q and at the same time should begin to exercise restraint on its marginal contribution to the expansion of bank credit and money, it might force an extreme crunch at the commercial banks. But if the System relaxed Regulation Q in step with market interest rate developments of recent months, the banks could avoid a great disruption of their customer relations, while at the same time the System could avoid continuance of an inordinate marginal contribution to the expansion of total credit, total liquidity, and money supply in the narrow sense.

Mr. Francis said he continued to feel that the discount rate was out of touch with reality.

Mr. Robertson prefaced his prepared remarks with a reference to the various comments that had been made in the go-around concerning the risks of a credit crunch. In his

judgment, he said, anyone forced to make difficult adjustments in a time of monetary restraint was likely to complain that a crunch existed. The System could not afford to be unduly sensitive to such complaints if it was to maintain restraint for the period required to cope with existing inflationary pressures.

Mr. Robertson then made the following statement:

> I think the facts we have before us today argue strongly that we bear down hard to maintain and, if necessary, even reinforce our posture of monetary restraint.
>
> While some financial indicators show signs of being affected by our actions, there are other measures that are still very buoyant. For example, despite professions of changed bank lending policies, the total of bank funds actually loaned to businesses continues to run high, fueling corporate outlays that are adding to inflationary troubles. To be sure, monetary policy takes time to do its work in this area, but I do not believe we can complacently assume time is on our side. Inflationary pressures also can cumulate over time, and the momentum of spiraling prices and costs is still proceeding apace, as the green book attests. I believe business attitudes on the whole are still very much conditioned by inflationary expectations. As long as that remains true, we have work yet to be done.
>
> In getting on with our job, we have to take account of both short-run and longer-run considerations. With the credit and deposit pressures likely to be associated with the March tax date less than two weeks ahead, and with another prime rate increase hanging fire day by day, I favor our maintaining our present firm hold on reserve positions for now. This could mean some rise in both borrowings at the discount window and in day-to-day market rates at times through mid-March as banks endeavor to adjust to the demands upon them, and that might be therapeutic. I would not think it helpful to add to such seasonal pressures, but I would not offset them either. Thereafter, there

> is a chance, recognized in the blue book, that bill rates and market pressures could ease off seasonally. If that starts to develop, I think the System ought to be poised to move in quickly with a countering policy action.
>
> My choice among our instruments for this purpose is still an increase in reserve requirements. As I said at our last meeting, I think our need at such a point would most likely be for a widely visible signal of curtailed reserve availability--and a reserve requirement increase ranks ahead of open market operations on the first count and ahead of a discount rate increase on the second. I would not want to rule out a discount rate increase under any and all circumstances, but I do think that fighting inflation with interest rates alone is not the right posture for us to be in. I would rather hold a firm line--on discount rates, Q ceilings, and reserve provision at the Trading Desk--and be prepared to throw a reserve requirement increase into the breach as unmistakable evidence to all banks and bank customers of our determination to persevere if and as any seasonal money easing starts to appear.
>
> On this basis, I am prepared to vote for the draft directive as submitted by the staff.

Mr. Robertson added that he thought the change Mr. Coldwell had suggested in the first paragraph of the draft directive would represent an improvement. He had no objections to having the two-way proviso interpreted in the manner Mr. Hayes had proposed.

Chairman Martin commented that the System presently was feeling its way with respect to monetary policy. Obviously, not all members of the Committee were completely satisfied with the way things were going. In view of the prevailing cross-currents and the problems of market psychology, however, it seemed to him that the System's main need at the moment was for patience. As various members had suggested today, further policy actions might

be needed later--involving, perhaps, reserve requirements, discount rates, Regulation Q, or open market operations. Mr. Robertson had indicated that an increase in reserve requirements might be the appropriate next step. However, he (Chairman Martin) thought that any such action was likely to be followed quickly by a need to increase discount rates; and he was not sure which of the two types of actions might best come first.

As to Regulation Q, the Chairman continued, he personally was not very happy with the way the ceilings had been operating. He thought it had been feasible to maintain the existing ceilings thus far only because of the safety valve offered by the Euro-dollar market. That safety valve obviously was not unlimited; the interest rates at which funds were available were a matter of significance to U.S. banks, and as had been reported today those rates had been rising sharply. In general, banks were faced with the same kinds of problems of gauging the future as the System was; they were unsure of the strength of loan demand in coming months and undecided about the desirability of an increase in the prime rate.

In his judgment, the Chairman continued, it was not clear that the appropriate degree of restraint on domestic spending had been achieved thus far. To review recent history briefly, monetary policy probably had been easier in the period before enactment of

the tax increase than it would have been if fiscal action had not been anticipated. After the action on taxes and on Federal expenditures there had been an error of judgment regarding the momentum of the economic expansion. Accordingly, to use a favorite phrase of his, the System was now wrestling with the heritage of past errors.

Chairman Martin remarked that it was important that Committee members not react mechanically on the basis of whatever statistics might become available. Recently, he had repeatedly found reason to question some implications of particular data. To take an illustration from the discussion today, Mr. Brill had reported that automobile sales had been slipping since last fall. But today's papers reported that sales had been good in the last ten days of February and one member of the industry had recently commented to him that the sales outlook was highly favorable.

Turning to the directive, the Chairman said he thought that the changes in the first paragraph of the staff's draft that had been suggested by Messrs. Coldwell and Brimmer were desirable. As to the second paragraph, he did not think a revision of the proviso clause shown in the draft was needed, since the Manager undoubtedly understood from the discussion today how the Committee intended that clause to be interpreted.

The Chairman then proposed that the Committee vote on a directive consisting of the staff's draft with the two changes he had mentioned.

In reply to a question by Mr. Coldwell, Mr. Holmes said he understood that the Committee would want the proviso clause implemented along the lines Mr. Hayes had suggested. Specifically, the proviso was to be activated on the downside if the adjusted bank credit proxy was approaching the lower limit of the projected range--that is, if it was declining at an annual rate of about 5 or 6 per cent in March--and if activation was not likely to change market expectations. On the upside, he understood that bank credit could grow at a rate of up to about 5 per cent before the clause was to be implemented.

Chairman Martin said he thought the Committee would be doing itself a disservice if it related its instructions for open market operations too rigidly to specific numerical projections of bank credit. In his judgment more flexibility was desirable.

> 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 information reviewed at this meeting suggests that expansion in real economic activity has been moderating, but that upward pressures on prices and costs

are persisting. Prospects are for some further slowing in economic expansion in the period ahead. Most market interest rates have edged up on balance in recent weeks. In the first two months of the year bank credit changed little on average, as investments contracted while loan demands, especially from businesses, remained strong. The outstanding volume of large-denomination CD's continued to decline sharply and inflows of other time and savings deposits slowed. Growth in the money supply moderated as U.S. Government deposits rose considerably. It appears that a sizable deficit reemerged in the U.S. balance of payments on the liquidity basis in January and February and, with Euro-dollar inflows moderating, a deficit also reappeared in the balance on the official settlements basis in February. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the reduction of inflationary pressures, with a view to encouraging a more sustainable rate of economic growth and attaining reasonable equilibrium in the country's balance of payments.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining on balance about the prevailing firm conditions in money and short-term credit markets; provided, however, that operations shall be modified if bank credit appears to be deviating significantly from current projections.

It was agreed that the next meeting of the Committee would be held on Tuesday, April 1, 1969, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

Attachment A

CONFIDENTIAL (FR)

March 3, 1969

Draft of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on March 4, 1969

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