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 22, 1966, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman,
Mr. Bopp
Mr. Brimmer
Mr. Clay
Mr. Daane
Mr. Hickman
Mr. Irons
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Shepardson
Mr. Treiber, Alternate for Mr. Hayes

Messrs. Wayne, Scanlon, Francis, and Swan, Alternate Members of the Federal Open Market Committee

Mr. Patterson, President of the Federal Reserve Bank of Atlanta

Mr. Holland, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Molony, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Brill, Economist
Messrs. Eastburn, Green, Koch, Mann, Partee, Solomon, Tow, and Young, Associate Economists
Mr. Holmes, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Hersey, Adviser, Division of International Finance, Board of Governors
Mr. Axilrod, Associate Adviser, Division of Research and Statistics, Board of Governors
Miss Eaton, General Assistant, Office of the Secretary, Board of Governors

Messrs. Latham and Strothman, First Vice Presidents of the Federal Reserve Banks of Boston and Minneapolis, respectively
Messrs. Eisenmenger, Link, Ratchford, Taylor, Jones, and Craven, Vice Presidents of the Federal Reserve Banks of Boston, New York, Richmond, Atlanta, St. Louis, and San Francisco, respectively
Mr. Nelson, Director of Research, Federal Reserve Bank of Minneapolis
Mr. Geng, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Stiles, Senior Economist, Federal Reserve Bank of Chicago

Chairman Martin noted that a new member was attending his first meeting of the Open Market Committee today--Andrew F. Brimmer, a member of the Board of Governors--and that Mr. Brimmer had executed his oath of office as a member of the Committee prior to today's meeting. The Chairman also noted that since the preceding meeting of the Committee Mr. Robertson had been appointed Vice Chairman of the Board of Governors.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 1, 1966, were approved.

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period March 1 through March 16, 1966, and a supplemental report for

March 17 through 21, 1966. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Coombs said the Treasury might soon have to transfer a sizable amount, possibly $75 or $100 million, from the gold stock to the Stabilization Fund. Otherwise, prospective orders between now and the month end would pretty well clean out the Stabilization Fund. The Russians were still out of the market and, while it remained possible that they might make some massive sales between now and the month end, the probability decreased with each day that passed. Meanwhile, however, the continuing prospect of Russian sales sooner or later this spring was helping to dampen market speculation, while heavy arrivals of gold from South Africa had also helped to relieve pressure on the gold pool. Earlier South Africa had been in the process of rebuilding its gold stock and had withheld gold from the market, but that situation now seemed to have turned, at least temporarily. So far this month, intervention by the London gold pool had been minimal.

On the exchange markets, Mr. Coombs continued, sterling had again been in the limelight, mainly owing to election uncertainties, sizable swings in monthly trade figures, and widespread rumors of possible discount rate increases in the U.S., in Britain, or on the continent. In trying to adjust to those pressures, the Bank of

England allowed the sterling rate to slip from a level of $2.8032 on February 16 to a low point of $2.7930 on March 9. That was a fairly steep decline and created the risk that selling pressures on sterling might cumulate on the way down. The Bank of England was very much aware of that risk and each day had consulted with the New York Bank on the state of sentiment in the London and New York markets. On March 9, the New York Bank staff had advised the Bank of England that in their view the risk of an adverse shift in market sentiment had become serious, and with the concurrence of the British the New York Bank had moved in to bid each bank in the New York market for sterling. That was more or less a repetition of the tactic employed last September 10, except that this time the rate was not pursued upward; the object was only to establish a temporary floor. In any event, the market reacted strongly upward and sterling had subsequently fluctuated in a quiet market within the range of $2.7945 to $2.7960. The Bank of England was well satisfied with the result of the operation, which provided another illustration of how effective such a tactic could be in stabilizing expectations. Indeed, it was so powerful that it was important it not be overused. The recent operation was only the second of its type, and he hoped that similar operations would not be required too often in the future.

Mr. Coombs said he understood that, in addition to dollars expended for market intervention and settlement of forward contracts during March, the Bank of England had reversed a $50 million swap drawing with the Bank of Italy and had also paid off another $50 million of short-term debt to the Bank for International Settlements. The British might again want to avoid showing a reserve decline at the month end, and so might approach the Federal Reserve for some type of credit facility. He thought that it would be appropriate to finance part of the reserve short-fall by a drawing on the swap line, but he hoped that the British would obtain the bulk of the funds they needed by drawing upon the $200 million of Treasury funds made available in the September package. He had already raised that question with the Treasury and was hopeful that they would agree.

At the last Basle meeting, Mr. Coombs continued, the Bank of England reported that they had obtained a sympathetic response from the International Monetary Fund to their request for a $500 million standby facility to provide a partial backstop for the $1 billion central bank credit package now under negotiation. The BIS might also be prepared to take $250 million of medium-term British bonds, equivalent to the U.S. "Roosa bonds," which would enlarge the backstop facility to a total of $750 million. In his view that probably would be adequate. If the Bank of England

were to use the whole $1 billion credit package provided by the central banks and then found that the market situation did not reverse itself within a year's time, the Bank could legitimately be expected to supplement the $750 million backstop now in sight by drafts upon its own reserves in the amount of $250 million, thus permitting full liquidation of the central bank credits. That, in effect was what they had done to repay drawings on the swap line with the System. There were other ways also in which the matter could be taken care of, and it would be a pity if the whole package were to be unduly delayed by debates over the absence of a backstop for the remaining $250 million of central bank credits.

Mr. Coombs concluded by noting that he had no recommendations to set before the Committee today.

Mr. Mitchell commented that in his judgment the "rescue" operations for sterling that Mr. Coombs had described were graphic cases of massive intervention in foreign exchange markets that did not reflect well on the System. He was sure that Mr. Coombs meant what he said about not using such tactics too often. But the Committee should be wary of yielding to the temptation to protect the market in a way that perhaps was hostile to the nation's long-run interests.

Secondly, Mr. Mitchell continued, he was concerned about the British use of its swap line with the System for window-dressing

purposes. That matter had been discussed by the Committee on earlier occasions, and it had been agreed that the System's own true position should be made known at all times. If the System had not met that goal perfectly, it had come close. He questioned, however, whether there was any substantial difference in principle between window dressing by the System and the Committee's permitting other countries to use its facilities for that purpose. Perhaps the latter could be justified at times, but not as a continuing policy.

Mr. Coombs said he would comment separately on each of Mr. Mitchell's two points. On the first, he perhaps had not expressed himself clearly in his earlier remarks. The New York Bank had intervened across the board in the sterling market on two occasions--successfully both times. The operation last September 10 probably was the one factor that had averted a possible serious breakdown of the whole international payments system. He hesitated to think of what the consequences might have been if it had not been successful. The operation had been used again on March 9, when the market was unsettled by the British elections, and it had given the market a lengthy breathing space. His conclusion was that the tactic was so powerful that the Committee would not want to dull its effectiveness by using it too often. But the Committee did have responsibility for defending the dollar, directly and indirectly. Given the power to change market sentiment when that sentiment was based on

exaggerated expectations and not on underlying realities, he thought the System would be derelict if it did not use it.

As to Mr. Mitchell's remarks on window dressing, Mr. Coombs said, he supposed it could be argued that to some extent the System was disguising the true position of the U.S. every time it drew on its swap lines and used the proceeds to buy dollars from foreign central banks, thereby avoiding gold losses. The System's swap operations were reported fully every six months, and he thought it was a reasonable procedure to make such reports after the market had had a chance to readjust. British drawings on the swap lines came to more or less the same thing; they strengthened the U.K. reserve position and forestalled reserve losses. The Bank of England reported any use of its swap lines each month, although they did withhold information on the amount of the drawings for several months. In one respect the British might be said to provide a fuller accounting than the U.S. did, since they reported drawings within a month whereas the System did so only at six-month intervals.

Mr. Mitchell expressed the view that the Committee should give a clear and accurate accounting of its operations. As to the British, in his judgment their failure to disclose the amount of their swap drawings was tantamount to no accounting at all. He then asked whether the System's swap drawings were reflected in its weekly statement.

Mr. Coombs replied in the negative. He remarked that such a suggestion would raise a major policy issue, and Mr. Mitchell agreed.

Mr. Daane commented that immediate disclosure of operations of the type being discussed clearly would have a market impact and in his opinion would be undesirable. The System did disclose such operations after an appropriate interval, and thus reduced the possibility of adverse effects.

Mr. Mitchell expressed concern that the Committee might be drifting into the position of saying that the market was not entitled to know the true situation. He thought that would be a dangerous position, and one that risked reactions that could lead to a worsening of the underlying situation.

Chairman Martin thought it was important that the Committee bear in mind the points Mr. Mitchell had made. At the same time, he did not think the Committee would want to go to the extreme of reporting all of its foreign exchange operations immediately, just as it would not want to announce its domestic policy decision following each meeting.

Mr. Mitchell agreed that the latter procedure would be undesirable. He added, however, that the information in the System's published statements gave knowledgeable people some idea of the nature of the Committee's decisions on domestic policy.

Chairman Martin commented that the situation with respect to the System's foreign exchange operations was affected by the fact that they were experimental and that the System had not yet accumulated a great deal of experience with them. It also was important to note that the existing foreign exchange markets had developed relatively recently; there were only fragmentary markets after World War II, until the major currencies became convertible in 1958. He shared Mr. Coombs' view that the two recent operations in sterling had been quite successful but if repeated too often such operations would lose their effectiveness. And he agreed with Mr. Mitchell that the Committee certainly did not want to engage in window dressing or to obscure the realities of the situation in other ways.

A discussion then ensued of the technical differences between the "across the board" operations in sterling of September and March and the more common transactions the New York Bank undertook for its own account or that of others.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System open market transactions in foreign currencies during the period March 1 through March 21, 1966, were approved, ratified, and confirmed.

Chairman Martin then invited Mr. Daane to comment on the meetings he had recently attended in Paris and Basle.

Mr. Daane noted that Mr. Coombs had referred briefly to the part of the meeting in Basle that was concerned with the British credit package. There also had been an extended discussion in Basle following the report by the Chairman of the Group of Ten on developments at the meeting of the Deputies in Paris during the previous week.

The Deputies met on March 7, 8, and 9, Mr. Daane said. The meeting took place against the background of reports in the French press during the preceding weekend that General de Gaulle had instructed the French delegation to take the position that there was no need for any new plan for reserve creation, even on the basis of contingency planning. The French made an extended statement of their position early in the proceedings at Paris and again at Basle. From both statements it appeared that the French position was about as follows: First, they did not believe there now was a need for any new reserve plan or for additions to liquidity. They stressed that their own suggestion for monetary reform, advanced in September 1963, had been based on the assumption that the U.S. and the U.K. would have restored equilibrium in their respective balances of payments, but that both countries still suffered from "massive disequilibrium."

Secondly, Mr. Daane continued, the French pointed out that in their earlier proposal for monetary reform they had suggested a

new asset closely linked to gold and created for a limited group of countries. They now found that in their discussions the Deputies had moved a long way from this French concept, and were considering a reserve asset not linked to gold. They also thought that by considering proposals to include countries outside a limited group in reserve creation, the Deputies were confusing the subject of aid to underdeveloped countries with that of liquidity creation. For those reasons the French felt that it was necessary for them to take the position that now was not the time either to consider actively or to put into effect a new reserve creation scheme. In their view the Deputies should confine themselves simply to "study and reflection" on the subject. They did say that the press stories had overdramatized the French position by implying that France would withdraw from the discussions. They had no such intention; they expected to participate in any discussions of reasonable proposals, but on a "study and reflection" basis rather than looking toward setting up a scheme for actual use in the foreseeable future.

The reaction of the representatives of the other nine countries, Mr. Daane said, was that they should attempt to move ahead with contingency planning. They did not agree that the Deputies should confine themselves to study and reflection, for several reasons. First, the mandate they had been given called for searching out areas of agreement, and not simply for coming back with suggestions

for further study. Secondly, there was of necessity a long time lag involved between the conception of a reserve asset scheme and its activation. That fact was emphasized by Mr. Deming of the U.S. delegation, who pointed out that even if the Group agreed in principle on some scheme, no new asset could come into being until 1968 or 1969 at the earliest.

Another point, stressed by Chairman Emminger and endorsed by a number of the delegations, was that a call for further study by the Group of Ten at this juncture would be extremely unsettling to foreign exchange markets and might provoke speculation in gold, since it would amount to saying to the world at large that the Ten were unable to devise a method for making the future international payments system viable. Finally, the Deputies had been instructed to include in their report suggestions for proceeding with the second phase of the exercise, and if they were to move into that second phase with widely divergent positions they would be exposed to consequences that no one really wanted. Thus, it seemed fair to say that the Deputies reacted negatively to the French position.

The Deputies group then turned to a lengthy discussion of the first of two papers put forth by the Belgian delegation, Mr. Daane said. That paper explained certain well-known Belgian proposals for modifying and strengthening the facilities of the IMF--for example, by making the gold tranche more automatic and changing its legal

status so that it could qualify as a reserve asset of member countries. There also was a fairly full discussion of a paper the Italians had submitted earlier, calling for the harmonization of gold reserve ratios. While that proposal seemed to elicit little enthusiasm, there was fairly general recognition that the problem had to be kept in mind in considering any reserve scheme. In effect, the Italian proposal was viewed simply as an element of any over-all reserve asset plan.

Also, Mr. Daane continued, there was a discussion of a long IMF document entitled "Need for Reserves," which took the position that reserves should grow at a rate of 3 to 4 per cent, or $2 to $3 billion, a year. The consensus at the meeting was that there was no really good way of quantifying needed reserve growth. That point was emphasized by Chairman Emminger with the support of the Dutch delegation, and also by Mr. Deming. It was noted that the figures used by the U.S. delegation at the previous meeting, and also those in the Emminger proposals, had been purely illustrative. At the same time, it was recognized that the question of needed reserve growth was not one for decision on an *ad hoc* basis each year. No delegation had specific suggestions on the subject, but there seemed to be agreement that reserve needs should be calculated on a global basis and in terms of longer-run trends.

The Deputies then turned to a question-and-answer discussion, along the lines of that held at the previous meeting, of another Belgian paper that put forth a new proposal entirely centered in the IMF and quite similar in some respects to one prong of the U.S. proposal. There was a proviso, however, that any country using the new automatic drawing rights would have to put up an equal amount of gold or make equal use of another ordinary IMF drawing right. There was little support for that aspect of the Belgian proposal.

Mr. Daane went on to say that Mr. Polak discussed a two-part proposal put forward by the Managing Director of the IMF for the creation of reserves through the IMF, so that the Fund now had a proposal of its own on the table. The first part involved quasi-automatic drawing rights similar to the special drawing rights of the U.S. proposal, which could be implemented without amending the Articles. Both the credit lines and the Fund's regular assets would stand behind the new drawing rights. The second part involved a reserve unit for all members of the Fund, to be created by an affiliate of the Fund. The reserve unit would be established by an exchange of claims between all members and the Fund affiliate. Allocation of units would not be made available to members with outstanding credit tranche drawings until they had been repaid in an amount equal to the allocation. One important aspect of the Fund's proposal was the sequence suggested; namely, to go forward initially

with the first part, with the expectation that it would be gradually superseded by the second part. The latter was envisaged as likely to prove the more flexible of the two.

With respect to the Deputies' future schedule, Mr. Daane said, a four-day meeting would be held in Washington on April 19-22, which hopefully would be the first report-drafting session. Another meeting would be held in Rome in mid-May to bring the report close to completion, with the aim of putting it in final form by late June or early July. The Canadian delegation had been asked to prepare a draft of the report's introduction before the April meeting, and three delegations, including the U.S., were to prepare suggested outlines. The outlines would be considered by a working party on the Monday preceding the Washington meeting, and then probably would be discussed by the Deputies. The objectives of the group seemed to be to continue to move forward and complete the report within the time schedule set; and to give it as positive a cast as possible, by stressing the areas of agreement--while, of course, noting the areas of disagreement.

At the subsequent Basle meeting, Mr. Daane remarked, Chairman Emminger reviewed the proceedings at the Deputies' meeting, and emphasized the need for a positive approach. Much of the discussion at Basle was a replay of that at Paris, but in some respects the thinking was at variance with that in Paris. There was a general

feeling at Basle that there was no need for additional liquidity now or in the foreseeable future, and there was little enthusiasm for the U.S. proposal or for any of the other proposals. The main emphasis was on the need for the U.S. to bring its balance of payments into equilibrium. However, there also was recognition of the problem noted in Paris--that it would be disadvantageous for the System as a whole if the Group of Ten report simply called for further study.

In concluding, Mr. Daane noted that Mr. Robert Solomon of the Board's staff was a member of the U.S. delegation at the Paris meeting and that Mr. Coombs had attended the Basle meeting. He thought they might have additional comments on the proceedings.

Mr. Coombs said he would note that the reaction he received in private conversations at Basle was one of serious pessimism as to the possible areas of agreement in the present negotiations. If that pessimism was justified it could have serious implications for the gold and foreign exchange markets.

Chairman Martin commented that he had discussed the IMF proposal, to which Mr. Daane had referred, at some length with Managing Director Schweitzer of the Fund. The proposal was an important one, and he thought it would be desirable, if possible, for copies of the full text to be made available to members of the Committee.

Mr. Daane remarked that copies of the proposal did exist. He noted, however, that the representative of the Fund at the Group of Ten meeting had made some rather sharp comments regarding leaks to the press of matters coming before the Deputies, particularly in connection with the French position and with the details of the Fund proposal. He was not sure how the Fund would react to a request for copies for use of the Committee.

Chairman Martin commented that he thought there was no danger of press leaks through the Committee. He asked whether Messrs. Holland and Sherman would explore the possibility of obtaining copies for the Committee, on the understanding that they would be treated as extremely confidential.

In response to a question by Mr. Hickman, Mr. Daane said that there seemed to be relatively greater support among the Deputies for some type of reserve unit creation than for additional drawing rights in the Fund. The U.S. proposal had included provision for drawing rights, and the Belgian proposal had involved only such rights. The British also supported such an approach, but with the possible exception of the Italians it appeared that no other delegation did.

Chairman Martin then invited Mr. Brill to comment on a meeting that he had attended in Paris last week, of the Economic Policy Committee of the Organization for Economic Cooperation and Development.

Mr. Brill said that the meeting focused on the domestic economic prospects and balance of payments outlook for a few key countries and on the issue of the effect of capital controls in the United States on European capital markets.

In commenting on U.S. economic prospects, Gardner Ackley, head of the U.S. delegation to the meeting, reported on some recent trends in sales and prices and indicated that, while the need for further restraint was not clear at the moment, the Government was prepared to adopt whatever measures should prove to be needed. Mr. Trued, the Treasury member of the delegation, challenged the pessimistic forecast that had been circulated in a Secretariat's preparatory documentation, and indicated a number of areas in which some improvement in the U.S. international position was possible. He (Mr. Brill) reported to the meeting on recent developments in U.S. money and credit markets.

There was considerable discussion, Mr. Brill continued, of the impact of U.S. monetary restraints and the U.S. voluntary foreign credit restraint program on European financial markets, particularly with respect to the absorption of capital market funds abroad through borrowing by large U.S. corporations. Representatives of the smaller industrial countries indicated the difficulties that were facing them in obtaining funds in European capital markets. The discussion went on to the subject of the need for improvement

in those markets and to the study currently underway under OECD auspices to devise methods for facilitating the flow of investment funds in Europe. It was agreed that that would be the principal topic at the next meeting of the EPC, scheduled for early July.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering open market operations in U.S. Government securities and bankers' acceptances for the period March 1 through 16, 1966, and a supplemental report for March 17 through 21, 1966. Copies of both reports have been placed in the files of the Committee.

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

> Since the last meeting of the Committee a new element of uncertainty has crept into the financial markets. Underlying market sentiment still anticipates pressure on financial markets and on interest rates in the months ahead, but expectations have become more mixed. There has been at least a pause in the upward movement of interest rates in long-term markets.
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> Underlying this new caution there appears to be a growing conviction that current monetary policy and interest rate levels are beginning to bite. Banks are now apparently taking a harder look at credit applications than for many years, and credit officers are learning to say no with greater frequency. The rapid rise in interest rates that has already occurred has now tended to make some borrowers consider postponing new loans, or at least not to rush into the market in anticipation of needs, while investors are beginning to find current rate levels increasingly attractive.
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> Of greater importance over the past week or so has been the market's feeling that the Administration may be

changing its mind about the need for a tighter fiscal policy. As a result, despite continuing evidence of economic boom and pressure on prices, the financial markets are beginning to wonder whether some change in fiscal policy on top of current monetary policy might not be enough to bring inflation under control. While this questioning is still tentative, it has been encouraged by the decline in stock market prices, and represents a new market element that may require our close attention in the weeks ahead.

Against this background, the System's move into new high levels of net borrowed reserves had in itself little impact on market rates, although Federal funds did rise to an effective rate of 4-3/4 per cent on 3 days during the period. While the rise in the prime rate from 5 to 5-1/2 per cent on March 10, just preceding the March tax date, evoked increases in rates on CD's, commercial and finance company paper, and bankers' acceptances, Treasury bills have been in good demand. In yesterday's auction average rates of 4.58 per cent and 4.78 per cent were set on three and six-month bills, respectively, about 8 basis points below rates in the auction three weeks ago, after a new high rate of 4.72 per cent had been set on the 3-month bill a week ago. Government securities dealers had come into the tax period in a strong technical position. Bill inventories were only moderate and dealers were under little pressure to absorb bill sales from corporations who were paying taxes, partly because of the large issue of March tax bills outstanding.

Money market pressures on the whole were surprisingly light over the tax date, despite a record level of borrowing from New York City banks. Banks seem to have made careful advance preparation for the tax date, including heavy borrowing from the Reserve Banks before the weekend, and there is some evidence that the net drain from maturing CD's was somewhat less than feared. In fact, on the final day of the statement week ended March 16 the funds market eased substantially and New York City banks were left with a cumulated excess of reserves of nearly $600 million which could not be disposed of in the Federal funds market.

The volume of System operations in the open market was relatively light during the interval. The System supplied about $225 million reserves on balance, partially offsetting reserve drains stemming from market factors

and permitting net borrowed reserves to deepen somewhat. Reserves were released as the Treasury permitted its balance at the Reserve Banks to run down to about $200 million as they passed through a seasonal low point in their cash position. The effects of this development in limiting the need for additional System action were fortuitous indeed, as conditions of acute scarcities and a rising level of demand in the Government securities market made it quite difficult to purchase these issues in large volume, either on an outright basis or under repurchase agreements. In this situation, the authority to operate in bankers' acceptances also proved to be particularly valuable, as the System was able on several occasions to meet part of the reserve need through acquisitions of these obligations under repurchase agreements.

During the period, the Government bond market had its first sustained rally in many weeks with yields on bonds in the 5-10 year area falling by almost 1/4 of a per cent, and longer-term bonds by as much as 1/8 per cent. At the close last night, no coupon issue was yielding as much as 5 per cent. The prime rate change had apparently been discounted in advance and reassuring press comments helped allay any fears of an impending rise in the discount rate. The strong technical position of the market was a major factor in the price advance; while there was moderate investment demand, there was significant dealer covering of short positions in light of the uncertainties noted earlier. By last Friday dealers had moved into a long position of $47 million Governments maturing in over 5 years compared with a short position of $56 million about 3 weeks ago.

Developments in the markets for corporate and municipal obligations roughly paralleled those in the market for Treasury issues. Distribution of new and recent offerings accelerated as investors displayed current willingness to commit funds at current rate levels, and yields declined from the high levels prevailing at the start of the period. By the close of the period there were no unsold balances in corporate accounts and municipal bond dealers had reduced inventories to about $350 million, the lowest level in almost four years. The markets derived additional stimulus late last week, when the underwriting bid for $440 million New Jersey Turnpike Authority bonds was rejected by the State.

It now appears that no further cash borrowing by the Treasury will be necessary over the balance of this fiscal year. The Commodity Credit Corporation is planning to borrow $500 million late this month by an auction of notes maturing in 4 months. Receipt of these funds should be enough to see the Treasury through its early April cash stringency, although there is still a possibility that the Treasury might have to turn to the Reserve Banks for accommodation for a few days.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period March 1 through March 21, 1966, were approved, ratified, and confirmed.

Chairman Martin called at this point for the staff economic and financial reports, supplementing the written reports that had been distributed prior to the meeting, copies of which have been placed in the files of the Committee.

Mr. Partee made the following statement on economic conditions:

The additional evidence which has come to light since the last meeting of the Committee supports the view that the economy is continuing to move strongly upward and is pressing harder on available resources. This is true even though we now expect a somewhat smaller first-quarter rise in GNP than the very large $16 billion gain of the previous quarter. Most of the slowing appears to be in inventory accumulation, for which our present estimates are highly tentative; final demands seem to have increased more this quarter than last, with expenditures rising along a broad front and defense purchases showing a particularly large increase.

The extent of the rise in consumption expenditures this quarter has been in some doubt, due to the leveling off in retail sales originally reported for January and February. But we now understand that the January sales

figures are being revised substantially upward, with February holding at the faster pace. The current sales level thus is well above the fourth-quarter average, indicating a substantial further rise in consumer outlays this quarter, probably exceeding our green book[1/] estimate of $7.3 billion. Personal incomes are continuing to rise very rapidly, and now that the initial impact of higher social security taxes has been absorbed, I would expect even greater strength in consumer demands. The new tax bill should have little impact on consumption, since the amounts of additional taxation involved are relatively small. And at mid-year the introduction of Medicare will provide additional stimulus to service outlays.

In the investment area, the new survey of plant and equipment spending intentions provides confirmation of our earlier expectations. The 16 per cent increase in spending planned for 1966 is very close to the projection included in the staff's chart presentation to the Committee at the previous meeting, and the time pattern of spending plans suggests a steady rise throughout the year. It should be noted that, in each of the two preceding years, actual expenditures considerably exceeded those anticipated in March. But I would not expect a similar result this year, mainly because production rates, manpower shortages, and lengthening backlogs in the equipment industries suggest that a much larger rise would not be possible, at least in real terms.

The whole economy, in fact, appears to be approaching closer to capacity constraints. Thus, the capacity utilization rate in manufacturing has edged up above 92 per cent and the recent further declines in the unemployment rate have been centered in unemployment among women and teenagers, suggesting that the pool of employable adult male workers is close to minimum levels. On the face of it, certainly, it seems doubtful that recent rates of real expansion can be long continued. The industrial production index, in January and February, increased at an annual rate of 11 per cent, well above

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

the 7 per cent addition to manufacturing capacity expected this year. And nonfarm employment in the same period increased by 250,000 monthly, a rate of gain which could not long be supported by expected growth in the civilian labor force.

The greater pressures on labor and plant resources seem also to be showing up increasingly in current cost and price developments. Hourly earnings in manufacturing still are rising at a steady and moderate pace, but it may be that larger wage increases are being offset statistically by the addition of marginal workers receiving less than average rates of pay. This notion is supported by a recent narrowing in the year-to-year gain in output per manhour in manufacturing, though that could also reflect other factors, such as labor hoarding and production bottlenecks. Whatever the reasons, unit labor costs seem now to be moving up. The large increase in January was mainly attributable to higher social security taxes for employers, but new data indicate that a further rise occurred in February.

New data also suggest some acceleration in the rate of price advance. Wholesale industrial commodity prices rose by one-half of one per cent in January and February combined; this translates into an annual rate of around 3 per cent, which is considerably more rapid than the 1-1/2 per cent rate of increase prevailing during most of 1965. A broad range of commodity groups showed appreciable increases in these two months, including many components of the key metals and machinery lines. The February rise in the total wholesale index, which received wide publicity, also reflected some sharp further advances in agricultural products; but average farm and food prices may now be at or close to their peaks, since the cycle in per capita meat supplies is expected to be reversed beginning in the spring.

In sum, the broad and pervasive advance in economic activity shows every sign of continuing, spurred by rising demands in every major sector of the economy except housing and, perhaps, net exports. Recent rates of gain appear unsustainable in a physical sense and, accordingly, pressures on costs and prices seem to be intensifying. Under these circumstances, continued tautness in the cost and availability of credit, and continuing substantial restraint on total credit flows, are essential components of appropriate stabilization policy.

This does not necessarily mean, however, that monetary policy should be tightened markedly further at this time. It seems to me that the Committee may wish to hold at about the present degree of restraint for a time, while the effects of earlier restraining actions--including the increase in the prime rate--are being communicated to the markets for goods and services. Given the lags in transmission of monetary policy, it clearly is still too early to gauge the extent of the impact on spending decisions in such areas as housing, public construction, business fixed investment, inventories, and consumer durable goods. Passage of time also may clarify the Administration's position on a tax increase, the outcome of which will be a major determinant of the degree of monetary restraint that will prove necessary to contain the economy.

Playing the waiting game of course involves risks--mainly the risk that the situation will get out of hand and inflationary momentum really pick up speed. But the risk seems to me fairly small, partly because of the already substantial degree of monetary restraint and partly because of the apparent continuing absence of a major ballooning in speculative sentiment. Consumers are spending freely, but not over-freely relative to incomes; business spending on plant and equipment is large, but not overly large in terms of present and prospective pressures on capacity; inventory accumulation is substantial, but perhaps not too substantial relative to growing output and sales; investor expectations of rising prices and profits are strong, but not so strong as to have prevented a sizable stock market correction. The developing economic pressures may appear substantial, but at this point I am not yet persuaded that a more drastic dose of financial medicine is required.

Mr. Hickman commented that if less efficient labor was now being employed in production the part of the industrial production index that was based on man-hour data might be rising faster than the part based on physical quantity data. He asked whether the staff had made a comparative analysis of the two parts of the index, and if so what the results were.

Mr. Partee replied that the staff made continuing comparisons of the implied rate of productivity increase in the two components of the index, and while he was not prepared to give a full report on those studies it was his impression that the rate of productivity gain had slowed in both.

Chairman Martin suggested that the staff might develop information on the subject for the Committee's use, and Mr. Partee indicated that that would be done.

Mr. Axilrod made the following statement concerning financial developments:

> Financial markets have recently caught their breath--and a deep one as it turned out--after a rather exhausting run since the beginning of the year, with interest rates in recent weeks generally losing part of their earlier increases. To market participants, the recent rally may be a result of their reflections on the distance they have come and on whether they have or have not out-paced such events as credit demands, monetary policy restraint, and the likely course of fiscal policy. For this Committee, the change in market atmosphere--no matter how brief or extended it turns out--provides an interlude for evaluating the effects of monetary policy on financial market conditions and monetary aggregates and for attempting to separate effects of policy actions from other market processes.
>
> Since the beginning of the year there still has been an over-all rise in interest rates of considerable magnitude in long-term rates and most short-term rates, while there has also been an apparently slower trend rate of growth in bank credit expansion. The lessened bank credit growth--which reflects both the reduced financial intermediary role of commercial banks as well as open market and discount policy of the Federal Reserve--appears to be both an effect and a cause of the rise in interest rates.
>
> At first short- and then long-term rates rose as a result of the December discount rate action and a considerable rise in demands on security markets in early 1966,

one consequence was a reduction in the financial intermediary role of commercial banks, whose net time and savings deposit inflows began to diminish markedly. Despite the increase in time deposit interest rates, corporations became less ready time deposit customers. At the same time it is possible that the higher interest rates that developed on U.S. Government securities as well as on corporate and municipal issues attracted some funds from individuals that might otherwise have gone into time and savings deposits.

Not only was the intermediary role of banks reduced but a further squeeze on banks was generated by the reduced availability of nonborrowed reserves as winter progressed and by the continuing higher cost of borrowed reserves. Most banks have made strenuous efforts to maintain their market position and most especially their customer relationships. But the resources to do so were not available and their efforts therefore fed back on market interest rates and contributed to the tightening of credit conditions. Banks, especially large city banks, were forced to liquidate U.S. Government securities, to reduce acquisition of other securities, and to raise the prime loan rate further.

The tightening of credit conditions has in turn apparently begun to have some impact in restraining the amount of over-all credit market borrowing. Since early March a number of municipal issues have been postponed, cancelled, or cut back, of which the most important was the recent New Jersey Turnpike issue. There have also been indications of some postponed private placements by corporations. In mortgage and consumer credit markets, some greater selectivity in lending appears to be developing. And banks have been reportedly stiffening lending standards. But it is certainly not clear exactly how to assess the effect of such financial developments on the amount or timing of spending.

While the recent pause in financial markets may be partly attributable to early signs of borrower aversion to high interest rates and greater lender selectivity, there has also been a general assessment that both equity and bond markets may have moved too far too fast in a kind of herd instinct over-reaction to a

change in the economic and financial atmosphere. A critical factor in extending this re-evaluation in credit markets has been the recent discussion of a more active use for fiscal policy--specifically tax policy--as a restraining measure. This has diminished expectations of a further discount rate increase over the near-term and generally resulted in some hedging of bets as to the inevitability, timing, and extent of future interest rate increases.

All of this does not mean that the months ahead will be devoid of further upward interest rate pressures; indeed, the recent decline in bond yields may itself be something of an over-reaction. It does appear, however, that credit markets may be completing their adjustment to the December discount rate increase and the first-quarter burst in credit demands, at the same time as the recent deepening of net borrowed reserves appears to be taking effect.

In evaluating the degree of monetary restraint associated with present levels of net borrowed reserves, one is probably justified in concluding that more restraint is being obtained per dollar of borrowings than in earlier periods. For one reason, the discount rate now is higher than in earlier periods of comparable bank borrowings; for another, banks have heavy CD maturities and are finding it difficult and expensive to roll them over; and finally, member banks are relatively more loaned up than earlier so that as they find loan demand continuing and their intermediary role reduced, lending terms tend to stiffen more. In the current circumstances, larger banks are apparently staying away from the discount window as long as possible--as testified by the margin of the Federal funds rate over the discount rate--since their needs for funds because of such developments as CD maturities cannot be readily represented as temporary.

Under the existing degree of monetary restraint, the money supply is showing an increase thus far in 1966 no more rapid than for 1965 as a whole, despite the rapid economic expansion and even though time deposits are increasing much more slowly than last year. However, any pick-up in member banks' demand for credit at the discount window could lead to some more rapid increase in money and reserve growth from recent levels. Continuation of loan demand, difficulties in obtaining time deposits

and short-term borrowings elsewhere, and a cumulative worsening of their liquidity positions are factors that could erode the current degree of bank reluctance to borrow from the Federal Reserve.

On balance, though, it appears as if the recent trend rate of expansion in monetary aggregates might just be continued with current levels of net reserve availability, as indicated by net borrowed reserves and the Federal funds rate. And it also appears as if this complex of conditions is exerting a restraint on borrowing that should begin to restrain marginal spending. Thus, maintenance of the present degree of net reserve availability may represent a fairly effective restraint pending further clarification of the economic outlook and resolution of the current fiscal policy debate. But if this course were adopted, there is some risk, as there always is when using a relatively fixed net reserve availability target, that an erosion of banks' reluctance to borrow at the discount window could generate a more rapid expansion in nonborrowed reserves as open market operations accommodated the increased demand--with the result that monetary aggregates could rise more rapidly and that upward interest rate pressure would tend to be offset as the monetary aggregates were supported by nonborrowed reserves.

Mr. Hersey presented the following statement on the balance of payments:

I should like to start out with a few words about the balance of payments since the turn of the year, and then go on to talk about prospects for the rest of 1966 and how they will be affected by policy decisions.

In the green book we used the word "significant" to describe the improvement in the payments position in January and February. "Significant" is a big word, and I'd like to explain just what we meant. First, the improvement was significant in the sense that it was more than just seasonal. Secondly, the improvement was significant in that the one explanation we can give for it is a rational explanation, and one that carries some encouragement for the future--namely, that the tightening of bank lending policies after the turn of the year brought a slowdown in the granting of new term loans to borrowers abroad.

Having said this, I must add that we don't have anything like full details of the January payments picture, and we have very little to go on for February except preliminary VFCR reports of further repayments of bank credit. More to the point, I must remind you that time and again the balance of payments has improved for a while and then worsened once more. In fact, there are very good reasons this time for thinking that a new worsening is what lies ahead once again--or what may lie ahead, if not prevented.

The major element of weakness in the U.S. balance of payments structure under present conditions is the acute strength of import demand. We have been seeing a very considerable spillover of domestic demand into demand for imported machinery, for imported finished consumer goods, for imported materials. Balance of payments analysts within the Government are now in agreement that there is a great likelihood that in 1966 we will continue to have disproportionately large increases in imports, as we did last year. Instead of hoping for a 10 or 11 per cent year-over-year increase, to a merchandise import total of less than $24 billion, we must fear a 16 per cent increase, to $25 billion. The rise within the year, from the very high fourth quarter of last year to the fourth quarter of 1966, may be somewhat less than 16 per cent, but it is not likely to come down to the 7-to-9 per cent range of the prospective GNP increase between the fourth quarters. Until the boom quiets down, until pressures on plant capacity are eased, and until protective inventory buying tapers off, we have to expect a more than proportionate advance in imports.

With this revision in agreed views about the prospect for imports, the outlook for the over-all balance is also altered. Instead of a deficit of less than $1-1/2 billion on the "liquidity" basis we have to fear a deficit of more than $2-1/2 billion. The assumptions underlying this projection include a somewhat larger rise in prices--and a somewhat larger rise in current value of GNP--than the staff projected for you at the last meeting. Also, this balance of payments projection doesn't allow for quite such a tightening of credit conditions and rise in interest rates as was pictured in the chart show. For these reasons, it may give too pessimistic a picture. But this new projection must be regarded as lying within the range of

realistic possibilities if nothing is done to prevent its realization.

The projection I have been describing does make some allowance for effects of the change in U.S. credit market conditions since December. However, if monetary policy exerts intensified pressure on U.S. bank liquidity and on non-bank corporate liquidity as the year goes on, it may become possible to chop another half billion dollars off the estimated capital outflow. Probably such a change would be most evident in three types of flow. First, the flow of bank credit could become an inflow, with repayments exceeding new lending. Secondly, the small inflow of corporate liquid assets we were still having in the fourth quarter could continue, rather than taper off. Thirdly, the net outflow to finance direct investment might be reduced below the program target if corporations felt so squeezed for liquidity that they would step up their borrowings abroad even more than now seems likely, or else might even cut back their foreign plant and equipment expenditure plans in order to reduce financing needs. As of December and January, these plans for plant and equipment outlays called for a whopping big increase of 24 per cent from 1965 to 1966, according to a special survey the Department of Commerce conducted. No one really knows just how flexible these investment plans might prove to be under pressure.

With further fiscal and monetary policy action, the current account of the balance of payments ought to do better also. The present view is that we have to fear a deterioration from a goods and services surplus of about $7 billion last year to one of only $6-1/2 billion this year. This deterioration would be ascribable to increased military expenditures abroad, but the failure to get any improvement would reflect the steep rise in imports. A moderation of the rise in U.S. prices and incomes and a toning down of the intensity of demand for plant and equipment and inventories surely would make the import picture less bleak.

The conclusion to which this all leads is that the U.S. balance of payments stands in need of all the help fiscal and monetary policy can give it. What it needs from monetary policy is not higher interest rates, _per se_, but rather a squeeze on the liquidity of banks and

business enterprises. So far as the external position is concerned, help of that kind just can't be overdone. At lease not until we have had a 12-month period with the payments position averaging out near zero on the "liquidity" basis--and that looks to be a long way off.

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

The most important event in monetary matters that has occurred since the last meeting of the Committee has been the increase in the bank prime rate from 5 per cent to 5-1/2 per cent. The increase was an appropriate response by the banks to recent economic and credit market developments. It should encourage the deferment of some credit demands, and should encourage business concerns in need of long-term funds to seek those funds in the long-term bond and equity markets.

Business activity is strong. The outlook is for further substantial expansion. Capital spending plans are strong. Unemployment has declined again. There has been further pressures on prices and wages. There have been a number of announcements of increases in prices. Labor leaders have indicated that they will push for wage increases without regard to the guidelines recommended by the Administration. There is more and more concern over the prospect of inflation.

For the first quarter of 1966 our international balance of payments appears likely to register a seasonally adjusted deficit not much different, on an annual basis, from the $1.3 billion deficit of 1965. Banks apparently are continuing to make a favorable contribution to the payments' situation, stimulated of course by large loan demands at home.

The demand for credit upon all types of lenders is strong. As banks have made loans in the face of a reduced inflow of time deposits, their loan-deposit ratios have risen further, and their holdings of U.S. Government securities have been reduced to levels lower than those of the tight money period of 1959-60.

Since the beginning of the year we have had several personal discussions with the heads of the large banks in New York City; and since the last meeting of the Committee we have had further personal discussions with practically all of them. Most of them report extraordinary loan demand. Most of them have reduced their holdings of U.S. Government securities and tax-exempt securities, and they are reluctant to make further reductions. Many of them consider their present holdings of U.S. Government securities as minimum holdings needed to guard against emergencies. Further liquidation of tax-exempt securities would generally bring substantial losses. The immediate capital losses coupled with the future loss of tax-free income could not be offset by loan income. Despite the increase in rates on certificates of deposit, the New York City banks as a group have not substantially increased the total of such deposits.

In general, the banks have been reviewing their lines of credit and have sought to trim them down as much as practicable. But some types of customers are going to need credit and are going to demand it. For example, many insurance companies have notified their banks to this effect. The banks feel they cannot say "no" to some customers. If a creditworthy customer has kept good deposit balances for many years, "he has earned credit," they say. If a bank were to refuse now to make a loan to such a customer, the bank would lose the customer for good and would lose his balances too. Thus, highly valued customers are likely to get loans in some amount, while other customers may not fare so well.

The banks recognize that they will not be able to satisfy all customers with good credit standing, and they have taken various steps to restrict lending to essential loans. In varying degrees the banks have encouraged customers to reduce the amounts of requested loans, to postpone borrowing, and to go to the capital markets rather than to the banks for credit. In some cases the banks have established qualitative tests, declining to make so-called non-productive loans such as a loan to purchase an additional plant or company where no over-all increase of production would result, or loans for speculative investments or purchases. In some cases banks have also established quantitative limits on total loans by various departments.

The recent increase in the bank prime rate should complement these other steps being taken by the banks, and should help cut down the growth of bank credit.

Although our inquiry of banks in the Second District outside New York City was much more limited, we are of the impression that those banks are not likely to experience as intense loan demand, and they are in a better position to meet the demand.

Turning now to reserve credit, net borrowed reserves have been over $200 million and member bank borrowings have averaged above $550 million over the last two weeks. These figures are somewhat higher than they have generally been since the increase in the discount rate in early December.

While net borrowed reserves and member bank borrowing from the Reserve Banks are not nearly as high now as they were in periods of restraint in the second half of the 1950s, the degree of restraint isn't correspondingly less. In the 1950s the banks had more U.S. Government securities which they could liquidate in order to make loans. In the 1950s, the negotiable certificate of deposit was not a ready fund-raising instrument. Today banks are paying high rates to obtain funds for a longer period either through certificates of deposit or persistent use of the Federal funds market; they prefer to do this rather than to borrow for short periods at a lower rate from the Reserve Banks. There is no doubt that the banks are now under pressure from monetary policy.

Last week the Tax Adjustment Act of 1966 was enacted. It should be helpful in providing some restraint on overall demand, but many informed observers question whether it will be adequate. In their view, a further increase in taxes, some reduction in contemplated spending, or both, are needed.

Despite the speed with which this recent tax legislation was enacted, further fiscal action is likely to bring more discussion and debate in the Congress, and the enactment of effective legislation could take much longer. A proposal for a tax increase is likely to produce debate not only on the nature of the increase and on whom it falls, but also on the question of what expenditures could properly be reduced. The likely result would be a compromise measure with some general increase in taxes and some cutback in spending plans. The Joint Economic Committee of the Congress has expressed its concern about inflation and

has urged fiscal action. The majority stresses increased taxes; the minority stresses reduced spending. In my view, the Congress, through its appropriate legislative committees, should be considering right now what further fiscal policy steps would be appropriate.

Monetary policy is taking hold, but it is still too soon to evaluate fully the implications with respect to the rate of credit growth. It seems to me that we should seek to maintain about the present degree of reserve availability. Consistent with this objective there might be net borrowed reserves fluctuating around $200 million, member bank borrowing fluctuating around $600 million, and Federal funds at 4-5/8 - 4-3/4 per cent most of the time.

I see no reason to change the first paragraph of the directive adopted at the last meeting, although I certainly see no objection to the change in the first sentence of the first paragraph of alternatives A and B prepared by the staff.[1/] Nor do I see any reason to change the last sentence of the first paragraph even though there be no change in policy. The goal is to moderate this year the growth in the three specified items that took place over a long time span that included last year. I doubt that we can be precise enough to say that current growth rates are the right rates that we should seek to maintain.

As for the second paragraph of the directive, I question the advisability of tying the goal to net reserve availability. I would prefer that open market operations be conducted with a view to maintaining about the current conditions in the money market. Net borrowed reserves would, of course, be an important factor, perhaps the most important, but not the sole factor.

Mr. Francis commented that, as suggested at the Committee's last meeting, he had talked to bankers at most of the large Eighth District banks about their demands for credit, actions they were taking to balance supplies and demands for funds, and their expected

1/ Appended to these minutes as Attachment A.

use of the discount facilities. Most of those contacted stated that the demands for credit were sizable and that they had had to be more selective in granting loans, especially to contractors and for real estate development. Regular customers were virtually all being accommodated to the normal extent, but much new business and large increases in old lines were being rejected. Compensating balances were receiving more consideration. Some bankers expected further interest rate increases in the near future; others felt that they had reached their peak. A few bankers expressed concern over the welfare of savings and loan associations in the current situation. Business loans had remained about constant since last October at large District banks, compared with the 20 per cent rate of increase at all weekly reporting banks in the nation.

In the discussions, Mr. Francis continued, none of the bankers thought they would have necessity for large continuous borrowing at the Federal Reserve. There was no resentment expressed concerning past treatment at the discount window. Some asked questions about the mechanics of submitting notes as collateral for their borrowings, and many believed that they might have need for more borrowing for short-term adjustment purposes. At the present time there were no serious cases of continuous borrowing, although there were three cases at the "watch closely" stage--but those were the repeaters.

The total amount of borrowing from the St. Louis Federal Reserve Bank had been higher in recent months, but the banks borrowing had generally paid off after a brief period. The discussions had pointed up great concern by bankers over further inflation. They understood the Federal Reserve attitude toward excessive discounting and he expected their cooperation with, at most, rare instances of attempted abuse.

Economic activity had been expanding sharply, Mr. Francis noted. Both in the St. Louis District and in the nation, total spending, employment, production, and incomes had been rising markedly in recent months. Expectations for future activity were exceptionally optimistic. Total demands had gone up faster than output, and prices had increased. He was inclined to believe that the increases in the general wholesale price index should be taken at near face value. It was true that some agricultural and food prices had risen exceptionally rapidly but, if supplies had been normal in that field of inelastic demand, total demand would have spread more into other areas and other prices would have gone up more.

Both monetary and fiscal actions had been expansive, Mr. Francis remarked, and it appeared that fiscal actions would continue to be stimulative. The "high employment" budget, which was at its lowest surplus level in many years during the last half

of 1965, appeared to be in deficit in early 1966 and was expected to be in even greater deficit later in the year. Bank reserves, bank credit, and money had risen at unusually rapid rates since last summer. Whether there had been any change in the rate of increase of monetary magnitudes in recent months was a matter on which there could reasonably be differences of opinion. In his view, bank reserves and the money supply had been following about the same trend since the first of the year as in the last half of 1965. It seemed to him that an illusion of a recently reduced rate of increase had been given by the bulge at year-end consisting of a great jump and subsequent partial loss of that increase.

With regard to policy, in view of the inflationary pressures, the very stimulative fiscal situation, and exuberant expectations, Mr. Francis suggested restriction in terms of slower rates of growth in member bank reserves, credit, and the money supply. Bank reserves and money might appropriately increase at rates that were significantly lower than the rate of growth of real product.

Several factors warned that restriction on the growth rate of money should be moderate, Mr. Francis said. The transactions demand for money was presumably rising, some bankers were asking customers for additional compensating balances, and there seemed to be few idle balances to draw on. Also with the rise in interest rates, the value of many assets held by businesses and consumers had declined. That

downward pressure on the value of assets and a resulting reduction in net worth might have some moderating effect on the propensities for real investment and other spending.

A substantial slowing of monetary growth would probably involve further firming of money market conditions and further increase in interest rates, Mr. Francis observed. There was some firming in money market conditions in early March which might induce some slowing of monetary growth. Nonetheless, he felt that in the absence of significant fiscal restraint some further tightening in money market conditions and possibly further interest rate increases might be necessary to obtain appropriate limitations on demand for goods and services. In many ways, he, of course, did not like those high interest rates and the accompanying restrictions on funds for real investment and economic growth. But they were, for the time being, imposed upon the Committee by the easy fiscal policy of the past nine months and the prospective future. In any case, the increasing interest rates had the benefit of making the balance of payments situation less troublesome than it otherwise would be.

Mr. Francis would not increase the discount rate at this time, although a case could be made that it was low relative to other money market rates. He would prefer alternative B of the draft directives, perhaps with some rephrasing as indicated by Mr. Treiber to eliminate reference to net reserve availability.

Mr. Patterson reported that a tighter labor market continued to develop in the Sixth District. Nonfarm employment had increased further with especially strong gains in apparel and wood and furniture products manufacturing. Average weekly hours worked in District manufacturing plants averaged 42.1 in January and probably had increased since then. The insured unemployment rate continued below the national level.

When it came to the financial sector, Mr. Patterson said, evidence of credit tightening was most evident in respect to rates. Most of the larger District banks had announced higher prime rates, but as yet no data were available to indicate how much of that had been translated into higher rates on business loans. The whole rate structure for consumer instalment loans was expected to move up very soon. Bankers surveyed in Atlanta, Miami, Nashville, and Birmingham reported that quoted rates had not changed but that effective rates were higher since they were now making practically no loans below quoted rates. Major independent finance companies in Atlanta had raised rates, and the captive finance companies seemed to be on the verge of change. If that happened, the banks would likely follow. A further increase in rates on floor plan loans, already increased in January and February, was expected. Auto sales in early March were very good in Atlanta, and preliminary

data suggested a substantial rise in automobile instalment credit extensions from January to February.

Total loan growth continued stronger this year, Mr. Patterson remarked, while business loan expansion was slightly greater, chiefly because of higher loans to trade concerns. Nevertheless, pressures for funds were limited to a relatively few banks, mostly the larger banks. Apparently, the banks as a group had not found it necessary to liquidate investments to meet loan demands. Only twenty-one banks obtained funds through the discount window last week, and net purchases of Federal funds were lower than last fall.

Mr. Patterson commented that the flow of funds into the District resulting from the greater-than-national rate of economic expansion might be responsible in part for the more comfortable position of the District banks. In part it might result from a deliberate policy to limit lending, judging from the preliminary reports received in the quarterly bank lending practices survey. Although all reports showed the demand for commercial and industrial loans as stronger, they also indicated firmer and more selective lending. None of the banks reporting were actively seeking loans. Also, the more comfortable position might be explained by the customary delay in transmitting changes in money market conditions throughout the country. Some effects of the recent tightening in the money market were now beginning to show up in the District,

however. Atlanta bankers reported an increased loan demand from customers who were shifting their borrowing from New York banks and utilizing previously established lines of credit in Atlanta. The relatively few District banks active in the CD market had adjusted rates upward in line with rates in New York.

Mr. Patterson went on to say that the churning in the Atlanta District illustrated very well that it took some time for any policy action to permeate the various sectors of the economy. Up to this time, the Committee had been able to observe only some of the effects of the policy move of a gradual reduction in reserve availability. For that reason, he did not favor further tightening at this time. Neither did he favor raising the discount rate. On the other hand, he believed the Committee should not dissipate the tightening effects of its recent policy action by raising the permissible ceilings on time deposits. In the event of a liquidity squeeze, he would prefer that, rather than raising the ceiling, banks under pressure for funds should be forced to the discount window.

In terms of free reserves, Mr. Patterson favored a net borrowed reserve figure of around $200 million. At the same time, however, he believed the Committee should pay close attention to the relation of the free reserve figure to the level of member bank borrowing, bank credit, and the money supply. Under conditions of strong credit demands, free reserves might become increasingly

unreliable as a measure of the effectiveness of policy. He favored alternative A of the draft directives with the amendment suggested by Mr. Treiber.

Mr. Bopp commented that developments in recent weeks gave some evidence that System policies of restraint were being felt in financial markets. The question now was whether still more restrictive action was called for to meet future developments, or whether to mark time for the present to observe further the effects of policy actions already taken. In looking to the future, one could construct models that would call for either course. A case for further restriction could be based on factors such as the following: possibility of escalation of the Vietnam effort; delay in raising taxes; further intensification of demands in the private economy, with inventory building and capital spending cumulating in anticipation of higher prices and shortages; growing tightness of labor; and further crumbling of the wage-price guideposts.

Another model would give different emphasis to some of the same factors, Mr. Bopp continued. In the absence of new information about the Vietnam effort, most current thinking was running along the line that the impact of defense orders would moderate after mid-year. In the private sector, the latest information on inventories provided some reassurance. Inventory accumulation slowed in January, and businessmen planned a slower rate of increase in the first and

second quarters of this year than in the fourth quarter of last year. Capital expenditures, it was true, now were forecast to increase about as fast as they did last year, and in this year's economy such an increase imposed considerable strain. There was some reassurance in the fact, however, that spending was expected to grow fastest in those industries that were hardest pressed for capacity. And it still seemed likely that new capacity would be coming on stream at least as fast as production increases.

In short, Mr. Bopp said, although it would be hard to find reasons why pressures on the economy might actually diminish, it did seem possible that the rate at which pressures had been building might slow down. The relative stability of the weekly figures on industrial prices recently offered some hope that that was the case, but it would be important to see whether the weekly data were borne out in the monthly index for March.

The difficulty of foreseeing the future, however, argued even more forcefully than usual for moving gradually as the situation unfolded, Mr. Bopp remarked. He was inclined to feel that policy actions already taken had been having considerable effect, and it might well be that their impact would intensify in coming weeks. Flows of money and credit had been more moderate recently, and rationing of credit, both by banks and the market, seemed to be increasing. If flows of money and credit were to

continue at those more moderate rates as the economy continued to expand, demands for funds might well increase sufficiently to produce higher interest rates.

As to conversations with leading bankers, Mr. Bopp observed that the Committee's discussion three weeks ago was too brief and inconclusive to answer questions that bankers legitimately asked during such conversations. The questions were not internally consistent, but they posed great difficulties on either horn of the dilemma. These were a few samples: "In the present environment, are you trying to tell me in a subtle way to ration credit rather than increase rates, particularly the prime rate?" It was agreed that the answer should be no; but Mr. Bopp wondered if an increase in the prime rate would have been attempted had the Committee launched a crash campaign immediately after its last meeting. "What criteria should I follow in rationing credit?" The discussion last time demonstrated only that there was no agreement as to what constituted "productive" credit, but that was not very helpful to a banker who was seeking help to cooperate in a general program. "Is this merely a first step down the road to guidelines?" Assurance that there was no intention to develop guidelines did not always remove growing skepticism of intentions.

Mr. Bopp said he had not made a series of formal appointments, one after the other, with the heads of the District's large

banks. He had, however, seized opportunities arising from other contacts to discuss the problem. Such contacts had arisen with most of those who had not been on winter vacations. He also planned to discuss the problem in the field meetings which would begin shortly and would cover the entire Third Federal Reserve District. He added that, on the basis of reactions he had been receiving, he anticipated widespread and deeply-felt adverse reactions to the latest revision in Regulation Q ceilings. That would not deter the Reserve Bank from meeting the issue head-on as it had met other issues annually over the years.

Returning to the question of policy, Mr. Bopp said that until the next meeting of the Committee he would be inclined to hold money market conditions about where they had been in the past week and observe closely the effect on financial markets and bank credit. If credit flows resumed their earlier rapid pace, further restraint might be necessary. He preferred alternative A of the draft directives.

Mr. Hickman commented that reduced rates of growth of bank reserves, bank credit, and the money supply in recent weeks indicated that the Committee's policy objectives were being met. Related developments in the stock and bond markets, including postponements of some municipal, turnpike, and utility financing, suggested also that the tighter policy was having "real" as well as financial

effects. It was difficult for him to determine whether the Committee's policy actions were evoking more realistic attitudes towards fiscal policy, but eventually high interest rates were bound to have some effect in that area as well.

Since the Committee appeared to have achieved quite a bit in a short time, Mr. Hickman thought it should pause now to observe the unfolding of what it had done. Therefore he would vote for alternative A of the draft directives, as submitted by the staff. Translating that into a specific target for the Manager, he came out with net borrowed reserves around $200 million, with borrowings averaging about $600 million. In his judgment it would be particularly important in this critical period for the Manager to be given leeway to deepen net borrowed reserves in the event of another surge in the demand for bank credit.

Mr. Hickman said he could add little to what had been said today and in the green book about the recent behavior of the statistical indicators, and would comment instead on the latest quarterly meeting of Fourth District business economists held at the Cleveland Reserve Bank on March 14. The overwhelming majority of that group--which, incidentally, represented a number of prominent national corporations in steel, autos, rubber, machinery, and related industries--called for a reduction in Federal nondefense spending and higher corporate and personal income taxes as the

best ways to cool off present inflationary pressures. No one favored the use of monetary policy alone at this juncture, and very few favored suspending the investment tax credit or imposing selective credit controls. Identical views were expressed at a joint meeting of the boards of directors of the Cleveland Reserve Bank and its Cincinnati and Pittsburgh branches, held in Cleveland on March 10.

Both groups--the economists and the directors--diagnosed the present situation as one of too rapid business expansion, with mounting pressures on resources and prices, Mr. Hickman said. The business economists' median forecasts for industrial production showed gains in each quarter through the first quarter of 1967, with the over-all percentage gain for 1966 expected to match that of 1965. For the second meeting in a row, not a single participant expected production to decline in any quarter in the year ahead--a record unprecedented in the 20-year history of that group.

There was much less certainty in the forecasts of inventory investment, Mr. Hickman commented, which was not surprising in view of the lack of reliable information in that key area. As was now known, many in the System, and apparently some in the Administration as well, completely missed the mark in predicting inventory behavior in the fall of 1965, which was a factor in preventing the framing of an appropriate public policy package to head off inflation. As

he had mentioned several months ago, something must be done about the deficiency in knowledge of inventories. He believed that the Federal Reserve System should offer some of its resources to overcome this major obstacle to timely policy determination.

The Committee might be interested in one other item discussed at the business economists' meeting, Mr. Hickman continued. There was a fairly general view that current plans for plant and equipment spending in 1966 could not be completely fulfilled because of physical and financial limitations. There was also a general feeling that capital spending plans might be revised downward because of higher construction and financing charges and uncertainties associated with bottlenecks in the supply of labor and materials.

Following the discussion at the last Federal Open Market Committee meeting, Mr. Hickman said, he talked with the chief executive officers of several of the larger banks--five in Cleveland, two in Pittsburgh, and three in Cincinnati. He explained that the System was now providing a reduced rate of reserve availability and that member banks in turn would be expected to reduce the rate of increase of bank credit, either through rationing or higher interest rates. The bankers were most receptive to the rate approach; subsequently all of them raised their prime rates to 5-1/2 per cent.

Since then, several of the same bankers inquired about the timing of the next increase in the discount rate, Mr. Hickman

remarked. He explained that rate relationships did not seem to him, personally, to be out of line with the discount rate, and that further discount rate actions would probably depend upon market forces of supply and demand. As a matter of fact, he believed that most of his board of directors would push for a higher discount rate if the 91-day bill rate moved much above 4.75 per cent.

Mr. Brimmer said he would not present a formal statement on policy today or comment on the directive; he thought it would be wise for him first to get his bearings and to learn something about the machinery of Open Market Committee policy-making. He would, however, offer a few observations on the balance of payments outlook. Personally, he thought it most unlikely that an estimate of the deficit for 1966 on the order of $2-1/2 billion would prove to be a reasonable one. Mr. Hersey had presented the results of the appraisal of an Interagency Committee which was in the process of revising its own forecasts. The Interagency group would be able to make a better appraisal after the fiscal policy situation was clarified.

In his judgment, Mr. Brimmer continued, Mr. Hersey's emphasis on imports as the most likely source of deterioration was correctly placed. A substantial deficit in travel and tourism also would contribute to the deterioration, as would military

outlays abroad and the foreign aid program. But the outlook for the capital account for 1966 appeared to be for substantial improvement relative to 1965. Preliminary evidence from the Commerce Department program suggested that corporations probably would not use the full two-year quotas permitted under the targets laid down. He thought the information that would be made available in a few days would show that corporations had got hold of the situation in 1965, and that the actual capital outflow last year was substantially less than anticipated. Of course, that meant that corporations had greater than expected leeway for 1966, and the problem was to persuade them not to use their full quotas. In any case, he expected the focus to shift from the capital account to travel and imports. Those categories might be somewhat more amenable to restraint by fiscal policy than others, and he saw no reasonable means for restraining them other than fiscal action.

Mr. Maisel commented that as was made clear in the blue book[1/] one got a somewhat different picture of growth in reserves and other credit factors depending upon which recent period one considered in his calculations. He had chosen, as one proper base, the biweekly reserve period ending January 5. By using the daily averages during that period, the base became approximately January 1

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

or the start of the year. As his final period he had used the daily averages for the current biweekly period ending March 16. Thus far this year, the money supply showed no increase while total reserves grew a little less than 4 per cent, the bank credit proxy grew approximately 8 per cent, and business loans were up 21 per cent, all at annual rates.

For the last month, using as a base the biweekly period ending February 16, Mr. Maisel found virtually no increase in bank credit, an increase of two-tenths of one per cent in reserves, and a 9 per cent increase in business loans; but a considerably higher rise than previously in the money supply.

It seemed to Mr. Maisel that considering both periods together the Committee was about on a proper target for the year. Mr. Axilrod today and the blue book both indicated that, under the present policy directive, reserves and bank credit would probably continue to expand at a rate roughly consistent with that which had prevailed so far this year. Therefore, he would support the present policies and alternative A of the draft directives. He assumed that the mix of variables should continue to expand at about the rate prevailing since January 1, and at a somewhat faster rate than had prevailed in the past month. He would think it proper for the Desk to react against large movements from the trend in growth of reserves by allowing net borrowed reserves to move in

the necessary direction. He would not substitute a money market goal for reserves in the directive since that might be construed as reflecting a concern with rates.

Mr. Daane remarked that he would make only a brief comment on policy today. He found himself in general agreement with Mr. Treiber, and was impressed that the Committee's policy was biting. Clearly, the problem facing the country--and it became even more clear as time passed--was one of inflationary pressures requiring some dampening down of aggregate demands, unless policy makers were prepared to accept the prospect of domestic inflation and of real deterioration in the balance of payments. But he was fearful that any appreciable tightening of System policy now would have unduly constrictive--even disruptive--effects on money and capital markets. Accordingly, he would keep the degree of pressure on the money markets that had been maintained recently. He would hope that at least an announcement of effective fiscal action in the form of a tax increase would come early enough to help the System avoid a difficult situation with respect to the discount rate. On that score, he personally was convinced that if such an announcement had been made earlier the increase in the prime rate would not have been necessary and probably would not have occurred.

As to the directive, Mr. Daane favored alternative A of the staff drafts, except that he would change the last sentence of

the first paragraph to conclude "... by continuing to moderate rates of growth in the reserve base, bank credit, and the money supply." He would accept Mr. Treiber's suggestion that the second paragraph be written in terms of money market conditions. That suggestion was consistent with Mr. Axilrod's point that at this juncture maintaining any fixed level of net reserve availability might produce conditions that were either too easy or too tight.

Mr. Mitchell remarked that he could vote for either alternative A or B for the directive, with or without the amendments proposed. He had a slight preference for B as amended, however, mainly because he thought the Committee should keep the banking system under as much pressure as possible during the next month or two without raising the discount rate. He noted that there were two strings to the bow of discount policy. One was the rate itself, which was not changed often. The other was the traditional reluctance to borrow on the part of banks which, he thought, could be reinforced by the Reserve Bank Presidents in discussions with borrowing banks, directed toward encouraging them to cut down on their lending. The banks already were under a good deal of pressure as rates on CD's approached the ceiling, and bankers were apprehensive about that situation because obtaining funds through CD's was no longer a very profitable operation. During March and April the System ought to do everything it could to persuade banks to cut down on their credit extensions.

Mr. Mitchell said he had to admit to some dismay when he heard suggestions that the System should advise bankers on the types of loans they should and should not make. When bankers were told they should not make loans for speculative inventory investments their response often was that they could not distinguish such investments from the non-speculative type. Advice to banks not to make loans for nonproductive purposes might well be wrong; such loans did not add to the demand for real resources in the first instance, and in any case later uses of the funds were uncontrolled. The problem had to be resolved by the bankers, since there was not much in the way of useful guidance the System could offer. Perhaps bank customers should be told to rely more on the capital market and perhaps anticipatory borrowing should be discouraged to the extent possible, but in his judgment those were functions that should be performed by the commercial banks and not the central bank.

Mr. Mitchell was somewhat surprised by the way in which Mr. Axilrod assessed the implications of the withdrawal of planned tax-exempt security issues. He did not think that kind of action was particularly helpful since it was not likely to have any effect on spending. He also was surprised to hear Mr. Daane imply that he did not like the prime rate increase; he (Mr. Mitchell) thought it was a helpful development. What would disturb him would be

another discount rate rise, and he did not think one was necessary at present. What was necessary was some further tightening with respect to extensions of bank credit.

Mr. Daane observed that he had not meant to imply disapproval of the prime rate increase; under the conditions prevailing he thought it was appropriate and necessary. His point was that the circumstances bringing about the need for a higher prime rate--which, in turn, foreshadowed a possible discount rate increase--would not have developed if there had been an announcement of some form of tax increase. That was a matter of judgment, but his personal feeling was that such an announcement would have had a calming effect.

Mr. Shepardson remarked that some of the information becoming available suggested that the Committee's policy actions were beginning to have a little effect. But other information seemed to indicate that there was still a good deal of inflationary fever extant in the economy. Since the Committee did not know what other policy steps might be taken, it seemed to him that it was faced with the need for doing its own job by keeping the pressure on through monetary policy.

At the previous meeting, Mr. Shepardson said, he had expressed the hope that the Committee would not be overly gradual in applying pressure, but many of the comments made thus far today

were to the effect that the move toward greater firmness, as gradual as it had been, should now cease. He favored maintaining the pressure by some further gradual increase in firmness, as indicated by alternative B of the draft directives. That might result in a deepening of net borrowed reserves, perhaps to a range between $200-$250 million. Although it was not clear to him how one would word such an instruction in the directive, he thought it might be appropriate to follow the course Mr. Robertson had suggested recently--that of letting net borrowed reserves fluctuate, depending on the strength of credit demands. If, as some seemed to feel, the demand for bank credit was slackening, net borrowed reserves would not have to be deepened as much. His own feeling, however, was that there still was considerable pressure on the banking system.

Mr. Wayne reported that Fifth District business continued to respond to strong expansionary forces. In a special survey of manufacturers, a substantial majority reported recent increases in the prices they paid for raw materials, machinery, and supplies; and a majority, though a smaller one, expected those prices to rise further in the weeks immediately ahead. Nearly one-fourth of those manufacturers reported recent boosts in their own prices, and nearly one-third were planning increases to become effective in the near future. Representatives of the construction business

and the bituminous coal industry also reported price increases put into effect in the past few weeks. Half of the manufacturers participating in the Richmond Reserve Bank's regular survey indicated a further rise in new and unfilled orders, and a good number reported increases in employment and hours.

In the policy area the indicators seemed to diverge a little but, on balance, Mr. Wayne saw no reason to change the Committee's posture of a gradual reduction of reserve availability. As Mr. Axilrod had indicated, there were a few signs that the policy of monetary restraint was making itself felt. Stock prices had dropped substantially and considerable amounts of new bond offerings had been postponed or cancelled. The money supply had registered one small decline and rates of growth had been reduced significantly for total reserves, bank credit, consumer credit, time deposits, and retail sales. The long rise in automobile production and sales might at last be leveling off as car inventories reached record levels.

But without doubt the economy as a whole was booming, Mr. Wayne said, with several sectors moving up at rates which could not be sustained for long. A number of major industries were operating at forced draft, beyond optimal capacity levels. The boom had attained so much momentum that the task of slowing it to a sustainable pace without precipitating a recession was an

extremely delicate operation. Recent movements in interest rates and the absence of any severe strain in the money market over the tax and dividend dates suggested that the monetary pressure was being applied smoothly and evenly. Further, the recent behavior of banking statistics might provide some evidence that the banks were acting more responsibly and with more restraint. In his conversation with leading bankers he found reasons for cautious optimism.

In the discussions Mr. Wayne had had with bankers in his District since the last meeting of the Committee, he found a profound concern with inflationary pressures which all thought were a problem not for the future but for the present. There was a general feeling to the effect that the leading banks of the country had lost control of their credit policies and were seeking a crutch to lean on. While the District banks said they were becoming selective in their lending policies, to many that meant that their primary concern was with the impact of their policy on the relative position of their bank, with less recognition of the implications for the national interest. He found the actions and policy decisions of leading banks varying from the extreme of one large bank which had established a policy that probably would result in reducing its relative position in the District by the end of the year. That bank was willing to follow such a policy

because of its concern with the national interest. At the other extreme were banks which felt strongly that unless some kind of crutch was provided nothing could be expected from the banks themselves.

Mr. Wayne went on to say that banks in his District thought the New York City banks had operated imprudently, and they were sharply critical of the New York banks for suggesting, when they ran short of funds, that their customers draw on credit lines outside of New York and thus relieve the pressure on them. The hope had been expressed to him that the System would not raise Regulation Q ceilings again because banks could not be relied on to exercise prudence in setting time deposit rates.

Mr. Wayne said he joined Mr. Mitchell in hoping that no voluntary credit restraint program would be needed. He thought it was naive to anticipate that, when the Reserve Bank Presidents talked with bankers, there would not be pressure for the System to provide some indications of the priorities to be followed in bank lending policy. He had done everything in his power to resist such pressure. It was clear, however, that the credit officers of banks would use the very fact that there had been a discussion with the Reserve Bank as a crutch on which to lean in dealing with their customers. Their willingness to enforce "credit restraint" simply meant that customers with substantial balances

would get the credit they needed and other customers would find it exceedingly difficult to do so.

Returning to his starting point, Mr. Wayne said he saw no reason for changing policy. It was important that monetary pressures be maintained and slowly increased, but the Committee should be alert for any evidence that pressure might be excessive. The behavior of the stock market might be interpreted as such evidence but he was inclined to doubt it. Since he saw no convincing evidence, he favored readoption of the existing directive without change. In his opinion the differences between that directive and the two new alternatives proposed by the staff were simply verbal.

Mr. Clay reported that since the last meeting of the Committee he had had discussions with most of the large banks in the Tenth District and several of the medium-sized banks. All reported unusually heavy loan demand from their regular customers, from business customers who had had lines of credit or loan commitments over a long period of time which they had never before used, from national companies that had been regularly pursued by those banks but never won, and from shoppers who were anticipating difficulties with their present banking connection. A number indicated that the New York banks evidently were telling some of their customers to "go west."

The one common response to those increased demands and limited availability, Mr. Clay went on, had been the increasing of interest rates over several months and now. The banks reported little resistance to increases. Several reported almost complete lack of success in getting rid of customers by substantial rate hikes intended to discourage without a direct turndown. All had taken some steps to slow or limit their loan expansion. Those steps covered the full range of possibilities and degree, and involved selectivity with respect to type, size, area, and so forth. There was a general feeling that they must take care of their regular customers, and--since they all anticipated continuing demand and further tightening--they were working hard to learn what demands they might expect from those regular customers in the months ahead. No banks had indicated that they would favor institution of a program of voluntary credit restraint by the System.

To date, banks were reasonably conservative in reaching for deposits, Mr. Clay said. Most of them wanted only local CD's, and were not trying to meet the New York market rates. There were exceptions to certain customers, but for most of them 4-1/2 per cent for six-month CD's was the high. They reported small growth in time and savings deposits over the past few months. Several reported efforts to increase compensating balances by relating rates more directly to balances.

There seemed to be a general understanding that all their potential demands could not be met indiscriminately at the discount window, Mr. Clay said, and general acceptance of the fact that there were and had to be limitations on the use of the discount window. However, there was great variance in the understanding as to what those limitations were or should be. He gathered that most of them had been studying Regulation A in recent days. Some concern had been expressed that the System would change its discounting policy to tighten administration of the window.

Mr. Clay then remarked that analysis of the factors that were pertinent to the formulation of monetary policy pointed essentially to the same kind of domestic economic situation as was apparent three weeks ago. The aggregate picture continued to be that of an economy in danger of trying to do too much too fast, with unfortunate price consequences. Accordingly, the monetary policy objective also remained essentially the same as before--namely, to facilitate credit expansion in keeping with the economy's capacity for real output of goods and services.

Some progress had been made since the last meeting in reducing the rate of growth in member bank reserves, Mr. Clay noted. Moreover, the policy objective had been carried out without disturbance in the money and capital markets, and along with the development of a less tense atmosphere in those markets. That

situation might afford an opportunity to pursue the same policy somewhat further. On the other hand, it would be well to proceed cautiously at this juncture in order to develop further evidence of the financial response to the action already taken. The net borrowed reserve target might be set in the range of $200 to $250 million for the period ahead. In pursuing that policy, it would be well to avoid placing such upward pressure on interest rates as would precipitate a Federal Reserve discount rate increase. Alternative B of the draft directives appeared satisfactory.

Mr. Scanlon reported there had been no diminution of the upward thrust of economic activity in the Seventh District. Reports of labor shortages and slow or incomplete deliveries of goods had become more frequent. Many capital expenditure projects were behind schedule because of delays in construction work or lack of availability of equipment. Automobile sales continued strong with sales for 1966 projected at 9.3 or 9.4 million units, about the same as last year. Truck sales recently had been at an annual rate of about 1.7 million units compared to 1.5 million last year. Here again, production would be even higher were it not for shortages of some components such as axles and transmissions.

Perhaps the most significant development of recent weeks in the District had been the step-up in demand for single family

homes, Mr. Scanlon said. Housing permits were up 10 per cent in the Chicago area in 1965 and there was a rise of 12 per cent for the four largest metropolitan areas of the District as a group, compared with a decline of 3 per cent for the United States. In Detroit there were critical shortages of workers in the building trades that prevented a larger volume of new construction.

Loan expansion at the big Chicago banks had been financed largely by CD sales, Mr. Scanlon continued, with outstandings rising by more than $250 million prior to the tax week. Replacement of maturing certificates from now until after mid-April might pose serious problems if rates on those instruments continued to rise. Chicago banks had acquired some additional bills, possibly looking toward April 1 needs in connection with the local tax date. Their bill holdings were not much below the level they had on hand prior to the tax assessment date last year when they apparently were able to meet demands satisfactorily. With reserve positions fairly comfortable through mid-March, reserve city banks had not borrowed heavily at the discount window but they indicated that pressures could be expected to increase in the period immediately ahead. The number of banks using and inquiring about using the discount facilities had been growing daily, as he gathered was the case elsewhere in the country.

Mr. Scanlon reported that he had visited with the chief executive officer of each of the major banks in Chicago individually,

and also had had conversations with a number of bankers in other reserve cities in the District, regarding the prudent rationing of credit in a period of credit restraint. Almost to a man, they felt that monetary policy was beginning to bite, sharply and rapidly; and they felt that bankers should prove they were bankers and face up to their responsibilities in this area without benefit of guidelines, written or otherwise. Several medium-size banks which felt they could not fully compete with money market banks in the CD market thought that the Federal Reserve should re-examine its discount window policies. They felt the System had encouraged banks to be more competitive and, as a result, the banks had gotten into longer-term investments. In light of that, they regarded the old criteria for judging steady borrowing as obsolete. In several instances, however, those were the views of banks to whom the Reserve Bank had been talking about their use of the window. Absent fiscal action, all of the banks apparently expected tighter monetary conditions given present credit demand.

Turning to policy, Mr. Scanlon said that because the full impact of monetary actions was not evident immediately, and the time effects of the recent reductions in capital values were still unclear, it appeared desirable at this time to permit some additional time for the economy to digest recent policy actions before considering further policy changes.

As to the choice of a directive, Mr. Scanlon was inclined to agree that there was little difference among the existing directive and the two alternatives proposed for this meeting. However, since he favored no change on policy he leaned toward alternative A.

Mr. Scanlon added that he agreed with Mr. Mitchell that some resistance at the discount window was desirable at present. He would caution, however, against any actions that might be interpreted as an arbitrary change in the standards by which appropriate use of the window was defined. Officers of the Reserve Banks had spent many years educating banks on that subject, and if the standards were to be changed he would favor doing so as a matter of general policy rather than in the course of informal conversations with bankers.

Mr. Strothman said his report this morning would look at the Ninth District economy from two aspects. One would be the Reserve Bank's view of District economic and financial developments as revealed by the available statistics. The second would be the current and near-term banking scene as seen by the heads of major banks.

It appeared that the District economy was still expanding at about the rate of the fourth quarter of last year, Mr. Strothman observed. According to the latest statistics, production and

employment gains were still substantially above what they were on average in 1965. Even the construction industry was getting on better than expected and, on slender evidence, might even be said to prosper. Building permit and employment data suggested that construction activity had recently been increasing much more rapidly than it had on average in 1965. The rate of increase of consumer spending did not seem to have slowed at all from the fourth quarter. Preliminary trade employment data and the recent behavior of consumer credit totals indicated that higher social security taxes had had little or no immediate effect on consumer spending in the District. The seasonally adjusted District unemployment rate for January, the latest month for which figures were available, was 3.1 per cent. The average workweek, seasonally adjusted, was 41.7 hours. Those data suggested a very tight labor market.

The banking statistics revealed a certain amount of the "pressure," or "tightness," of which so much had recently been heard in banking circles, Mr. Strothman remarked. Loans by District banks had continued to advance at a rapid pace, but with the February and March increases somewhat more modest at country than at reserve city banks. Commercial and industrial loans had dominated the increase for February, while loans to nonbank financial institutions accounted for nearly all of the increase in

the early March period. Meanwhile, deposit outflow in February was much heavier than usual but growth in the early March period was above normal. The average loan-deposit ratio for Ninth District weekly reporting banks was higher now than it had been for a long, long time--in fact, at 66 per cent it was at an all-time high for the series--and one suspected that the same might be true for non-weekly reporting banks. Their ratio, at 55 per cent at the end of February, was but one point shy of an all-time high on an unadjusted basis.

Borrowings by the reserve city banks had averaged about 40 per cent of required reserves, Mr. Strothman observed. That was a lot of borrowing, especially for so early in the year. On the other hand, such a scale of borrowing was not without precedent. Also, it was to be noted that District banks--only a few of the largest would be involved--suffered no real embarrassment as a result of the early March maturation of a large portion of their negotiable CD's. Actually, reporting banks' CD's increased more than seasonally in the three weeks preceding March 9. In the week ended March 16 there was a relatively modest loss.

Turning from those elements of the District financial picture as seen by the Reserve Bank to the view as described by bankers, Mr. Strothman noted seeming differences in perception. The major bankers had characterized the situation with such

expressions as "desperate" and "as tight as I have seen it." Their banks had registered all-time loan highs in mid-March, and the pressures continued. They said they were confining lending to regular customers and were trying to hold them to appropriate purposes. He would inject, however, that the Reserve Bank's instalment loan survey indicated that, despite tight credit and customer-selection policies, over-all consumer instalment credit had increased and that the larger banks, at least, had not endeavored to curtail the allotment of funds to their instalment loan departments. Actually, there was some information to the effect that increased activity in that area was perhaps encouraged by the banks' management.

As seriously as the District's larger banks viewed the loan demand situation, it appeared to Mr. Strothman that they were equally concerned about the extremely large volume of negotiable CD's maturing in April. One banker expressed the fear that most of those could not be renewed at any price. He asserted that if there was to be a banking crisis it would come next month, with the CD run-off coinciding with a further intensification of the loan demand.

Mr. Swan reported that the expansion in business activity had continued in the Twelfth District as elsewhere. The Pacific Coast States experienced a substantial employment increase in

February which, combined with a much smaller increase in the labor force, resulted in an unusually large drop in the unemployment rate to 4.6 per cent, from 5.1 per cent in January and 5.4 per cent in December. Once more the aerospace companies added significantly to their work force in February, and they accounted for almost one-half of the total increase in manufacturing employment in that month.

Lumber markets had come under rather severe pressure in March, Mr. Swan said, reportedly because of the combination of a large volume of Government buying and some anticipatory private buying against the possibility of a strike when the current labor contracts expired on June 1. That buying had pushed lumber prices up rather sharply this month.

District banks were under some reserve pressure in late February and early March, Mr. Swan continued, and had sold a rather substantial volume of securities. In the three weeks ending March 9 the loan decline was about the same as a year ago, but the decline in investments was much sharper. However, the banks apparently had over-allowed for expected loan demands in connection with the March tax and dividend dates. After being net buyers of Federal funds through the first week ending in March they were net sellers in the week ending March 9, and like the New York banks they had ended the following week with funds they

were unable to dispose of. As of last Thursday they again expected to be large net sellers of funds in the current week. Their comfortable reserve position also was reflected in the fact that borrowings from the Reserve Bank dropped sharply in the week ending March 16.

District banks were maintaining posted CD rates at levels somewhat higher than earlier but still a little below those in New York, Mr. Swan remarked. They admitted freely, however, that they would move their CD rates to the ceilings in individual cases if necessary to retain substantial balances of national corporations. Rates on savings certificates had edged up a little but also were still below those in the east. As of last week, the major banks were maintaining a 4-3/4 per cent rate on savings certificates and seemed to be a little nervous about going to 5 per cent.

There had been a good deal of concern about the flow of funds to savings and loan associations. In January, the latest month for which figures were available, District savings and loan share accounts rose slightly--by $112 million--to a total of just under $26 billion. That compared with a slight drop for the country as a whole in January of this year and to an increase in the District in January 1965 of $154 million. Real estate loans of District associations rose only $90 million in January, the smallest monthly increase since April 1958. Their borrowings from

the Home Loan Bank and other sources were down about $100 million in the month. Such borrowings had declined in the country as a whole, also, but associations in the Twelfth District accounted for about 60 per cent of the national reduction.

In talking with the major San Francisco banks, Mr. Swan said, he found that they were well aware of the loan demand situation they faced. They all reported strong demands and some mentioned a spillover from national concerns that were not getting all of the credit they needed from New York banks. The District banks indicated that they had adopted a somewhat firmer attitude with respect to both rates and other loan terms. They had raised rates not only on prime loans but on other borrowings as well. One interesting case was that of a major bank that had just notified its branches that it was increasing the rates on automobile loans, effective March 15, when the prime rate was raised. The bank rescinded the notification, not because it did not want to raise auto loan rates but because it wanted to increase them more but preferred not to change them in two steps.

The banks also indicated that they were somewhat less willing to make term loans and loans for real estate development, Mr. Swan continued. They apparently were eliminating a few of their marginal borrowers and were pressing for larger compensating balances, although he had some question about how successful they

were in the latter respect. They were less willing to accommodate borrowers without established customer relationships, except for particular borrowers that they had long wanted to accommodate. The banks had sold a fair amount of real estate mortgages and some were actively seeking to make further sales of such mortgages. However, the fact remained that, at this point at least, Twelfth District banks certainly were not in as tight a position as the New York banks.

Mr. Swan went on to say that the major banks in the District were unanimous on one point that came up fairly early in the discussions--they hoped that the 4 per cent maximum rate on savings deposits would not be raised, for two reasons. First, higher rates would add to their costs on the large volume of savings accounts they had outstanding. They had experienced some shift out of savings accounts into savings certificates, but it had not been great; and while there had been persistent small declines in their total savings deposits, most recently that trend was reversed. Secondly, they were concerned about the possible adverse effect on savings and loan associations of an increase in rates on savings accounts. The rates currently offered on bank savings certificates did not appear to be attracting funds in substantial volume from local savings and loan associations, but a higher rate on savings deposits might well do so.

In terms of policy, it seemed to Mr. Swan that recent developments were just about what the Committee had expected when it undertook its program of gradual reduction of reserve availability. Like some others today, he did not have a strong preference between the staff's two draft directives. On balance, however, he thought it probably would be better to maintain the present degree of pressure and not to intensify it. Perhaps there still was some market reaction remaining to be assessed; and, while developments associated with the March tax date had not posed any great problems, it might be desirable not to take a further step until after the April 15 tax date. Accordingly, he leaned toward alternative A for the directive, and he would be inclined to try to keep net borrowed reserves around the $200 million level. As to whether the second paragraph of the directive should be written in terms of money market conditions, as Mr. Treiber suggested, or in terms of net reserve availability, as in the staff draft, he would suggest a compromise: to accept Mr. Treiber's proposed language, but to add the words "including the present level of net reserve availability".

Mr. Swan did not think it was necessary to raise the discount rate at this point. The System might not have to consider discount rate action until bill rates were substantially higher than at present or there was a substantially larger volume of member bank borrowing.

Mr. Swan supported Mr. Scanlon's remarks about the attitude to be taken at the discount window, recognizing that the Reserve Banks should take a firm position toward continuous borrowers and borrowing for inappropriate purposes. He noted, however, that there could be a substantial increase in borrowing without a change in policy. In particular, certain large banks had not borrowed for a considerable period; and if they should begin to do so--which he was not necessarily predicting--it obviously would be difficult to attempt to discourage them in view of their previous record.

Mr. Irons said that he had talked informally with the presidents of perhaps a dozen banks in the Eleventh District during the past three weeks, of which about half were large banks and half small. Like Mr. Wayne he had heard from a few banks some rather sharp and severe criticisms of the New York banks--not only for suggesting to customers that they "go west" for accommodations, but also for working up the rates on CD's. Rightly or wrongly, some bankers in his District blamed the New York banks for the present CD rate levels. Also, some of the bankers contacted had commented that they hoped there would be no further revisions in Regulation Q. Mr. Irons pointed out, however, that care should be taken in generalizing from a few contacts.

Regarding the discount window, Mr. Irons said that borrowings at the Dallas Reserve Bank had not been sizable, and

he did not anticipate that they would become heavy, as long as funds were available in the market from other sources. He expected the Bank to continue to administer the window as it had in the past, in the manner prescribed by Regulation A. While District banks were borrowing relatively little, however, they were substantial buyers of Federal funds. Last Friday, for example, borrowings at the Reserve Bank totaled only $8 million, but 5 or 6 major banks held over $250 million purchased in the Federal funds market. Obviously, banks were getting a large part of the money they needed in the funds market, a source over which the System had little control.

Mr. Irons noted that the bankers with whom he had talked fully recognized the tightness of the credit situation and expected it to become tighter. They were seeing strong loan demands and said they were being more restrictive in their lending policies. Perhaps banks could not distinguish precisely between productive and nonproductive loans but the bankers contacted thought, at least, that they were limiting their lending as far as possible to productive as against speculative purposes. One of the large banks indicated recently that it was revising its loan budget for the year downward by a significant amount. There was no lack of awareness of the need for credit restraint, and banks were responsive to that need. At the same time, banks had

their own competitive positions to consider. The result was likely to be cooperation by banks with respect to their lending practices, within the limits set by the competitive situation.

Turning to economic conditions in the Eleventh District, Mr. Irons reported that they were very strong in all areas. The employment situation was tight and becoming more so, as the need for skilled labor rose with the increase in production of defense materiel. Texas plants had received about one-half billion dollars in defense orders in the last quarter of 1965 and those orders were beginning to flow through the production process. A large helicopter manufacturer recently had received an order for 2,000 machines; the firm had been producing helicopters at the rate of 60 per month, and it was attempting to find the skilled labor necessary to step up production to 160 per month. Defense orders, which were likely to continue to come in at a substantial rate for some time, were creating a labor problem. District manufacturers were scouring the country for skilled labor, looking particularly to the areas of high unemployment. One firm had instituted a training program in cooperation with the Department of Labor. In short, the District economy was one of full employment and full production, triggered by defense orders.

As to policy, Mr. Irons was rather pleased with the developments over the past three weeks. He also was pleased with the

current discussions about the possibility of action in the area of fiscal policy. The comments being made on that subject were rather contradictory and confusing, but the fact that the subject was being talked about more was, in itself, a good sign and might have some effects on expectations and on price developments. There was no question in his mind but that the Committee's recent policy was beginning to bite. He noted also that there had not been much distortion in financial markets.

For the coming period Mr. Irons favored maintaining the policy that had been followed for the past three weeks. He would not suggest any absolute figure for net reserve availability, but thought that net borrowed reserves might be somewhere in the $200 million area, or perhaps $200 million plus. With net borrowed reserves at $200 or $250 million the Federal funds rate might range around 4-5/8 to 4-3/4 per cent, and the rate on 3-month Treasury bills might move up to 4.70 per cent or slightly higher. He did not think there should be an attempt on the part of the System to force interest rates upward, and he hoped that market factors would bring about a satisfactory situation.

Mr. Irons favored alternative A of the draft directives with Mr. Treiber's proposed amendment to the second paragraph. He thought it was better to call for maintaining current money market conditions rather than, even if only by implication, for some specific level of net borrowed reserves.

Mr. Latham reported that all segments of the New England economy continued to approximate the national expansive trends. Unemployment had steadily declined. Manufacturing production and new orders were strong, and consumer spending continued unabated. A preliminary tabulation, based on a 24 per cent employment coverage, of New England manufacturers' capital expenditure plans for 1966 had a decidedly bullish tinge. The indicated planned capital expenditures for 1966 were 32 per cent in excess of the actual 1965 total, which in turn exceeded the 1964 total by 16 per cent. Those planned expenditures were about equally spread between durable and non-durable goods producers. There was, however, a wide range among industries, from 85 per cent in transportation equipment to 4.3 per cent for the electrical machinery industry. Planned expenditures for plant were expected to increase by 55 per cent and those for equipment by 26 per cent, with the latter accounting for 76 per cent of the total dollar expenditures. It was interesting to note that the Reserve Bank's 1965 spring survey of capital expenditure plans closely approximated actual expenditures for the year.

The short-term liquid asset ratio and the loan-deposit ratio reflected the pressure on banks for credit accommodations and the need for funds, Mr. Latham observed. As of March 9, 1966, the loan-deposit ratio of District member banks stood at 77 per cent

and at Boston member banks it was 82.5 per cent. The short-term liquid asset ratio was only 1.5 at Boston banks and 5.2 for the District.

In the past week Mr. Latham had talked individually with the senior officials of the ten largest commercial banks in the District for the purpose of discussing the need for credit restraint. Without exception, they stated that they not only were under considerable pressure to meet the expanded needs of their regular customers, but they also were being offered participations in loans which were not previously available to them. Mutual savings banks, insurance companies, and other customers were inquiring as to the continued availability of their little-used lines. Bankers contacted indicated that they were definitely attempting to limit credit to productive uses, but admitted that "productive use" was open to a wide range of interpretation. With only one exception, no attempt had yet been made to limit consumer credit other than by raising rates. The one exception was a bank reporting that its consumer credit portfolio had been fixed at the balance outstanding at the end of February. Bankers stated that they were extending very little credit to new customers unless good compensating balances were obtained. Some said they were setting up repayment schedules on long-outstanding collateral loans and were trying to get accounts receivable loans taken over by finance companies.

Evidence was reported of customers reacting to the credit squeeze in a twofold manner, Mr. Latham said. Good customers were increasing the amount of credit requested in anticipation of having their requests cut, and other large firms, particularly utilities, which had agreed to seek the public market for needed long-term funds, were now shying away and again seeking bank credit. Some bankers indicated that they were being approached by marginal concerns that they knew were being turned down by banks that had previously met their credit needs.

The question was repeatedly asked as to what the Boston Reserve Bank's policy would be with respect to the administration of the discount window, Mr. Latham remarked. All bankers expressed the opinion that public demand would have to be curtailed and that a firm fiscal policy was in order. He added that it had been some time since bankers were last put in a position where they were required to say no to bankable credit requests, and they were finding it difficult to do so.

Mr. Robertson then made the following statement:

> There are one or two less strong readings among the economic signals being reported to us this morning (*i.e.*, less strong inventory growth in January, slower rise in retail sales, and lower housing starts in February), but the overwhelming bulk of the signals is still continuing to come in strong. Expansion of demand is building up real pressure on resources. The rise in the wholesale price index for industrial commodities picked up in February, and supplemental

information suggests that price increases are becoming more pervasive.

In these circumstances, I believe that responsible public policy calls for action to moderate the rate of growth of demand. As most of you know, I am one of those who would like to see some excessive demands trimmed by a further round of fiscal tightening. I suspect many of us around the table are agreed on this, with the arguable points being whether a tax increase is obtainable and when and how much it might be. On these points, it seems to me that the wisest attitude is not to be so skeptical as to expect no further tax increase at all this year, but, on the other hand, not to be so certain of its likelihood and efficacy as to lay back on the monetary oars and coast. To my mind, continued gradual tightening of reserve pressure is the proper order for the day.

I think there is some reason for us to be gratified with what has been accomplished with gradual reserve tightening over the last six weeks. The rate of total bank credit growth seems to have been slowed down, there has been some lessening of bank loan availability, and this has been accomplished without a major dislocation of financial markets or interest rates. Any tendency toward complacency in the light of these achievements, however, should have been jarred by the upsurge in business loans and money supply just before and over the March tax date. Until and unless those increases prove to be temporary, some partly offsetting firmness in reserve posture ought to be sought.

This seems to me to be another situation in which we could benefit by framing our directions to the Manager in somewhat more flexible terms. To be explicit, I would like to see net borrowed reserves averaging around $200 million, but I would be prepared to see this figure drop to $300 million should bank loan and money supply expansion hold up strongly and expand required reserves in the process. On the other hand, I would be prepared to see net borrowed reserves move back to a level closer to $100 million if bank loan and money movements slacken and required reserves decline more than seasonally. On the record, I believe this kind of flexible instruction would have worked out rather well over the past three weeks, and I think it could prove equally apt in the uncertain weeks ahead.

> With this understanding of preferred operating techniques, I would be prepared to vote in favor of a renewal of the existing directive, or of Alternative B, if we want change simply for the sake of change. I would not want to expand this language to give any special attention to money market rates. I think the purposes of the Committee have been well served by our recent greater emphasis on reserve availability, and I think we should continue with this kind of policy.

In connection with Mr. Robertson's concluding remark, Mr. Shepardson noted that several of the speakers around the table had indicated that they favored no change in policy and then had expressed a preference for alternative A for the directive. He would interpret no change in policy as calling for either readoption of the existing directive or use of alternative B.

Chairman Martin indicated that he favored readopting the existing directive; it seemed to him that little, if anything, was added by the language changes made in either alternative A or B. It was clear that the majority today favored keeping the pressure on, but not applying it too stringently. A number of people he had talked with were generally agreed that the money market had been handled quite well recently. While there were no grounds for complacency, he thought the Committee had come through the year-end period well, and it was evident that its policy now was biting.

In a recent conversation on the subject of credit rationing, the Chairman continued, it had been suggested to him that "rationing" was the wrong word; what was really needed was intelligent

administration. He hoped that the System would administer the discount window intelligently and that bankers would be asked to become bankers again. Since there were twelve Reserve Banks with discount windows to administer, completely uniform standards could not be expected. Basically, however, what the System was trying to do was to restrain bank credit growth as much as reasonably possible. At the same time, it would be desirable in many cases for banks to use the discount window in preference to other forms of borrowing because the System could control the volume of discounting. For a long time, he noted, many banks had not been coming to the window at all. Consequently, the window should not be administered in too heavy-handed a manner; it was necessary to weigh requests for accommodation in the light of general policy objectives. The go-around today had been quite helpful, he thought, in pointing up the problem.

Returning to the subject of the directive, Chairman Martin said that in his opinion Mr. Robertson had stated the matter correctly--the modifications of language in the staff's two alternatives seemed mainly to involve change for its own sake. He suggested that the Committee vote on whether to readopt the existing directive.

Mr. Hickman said that he agreed with Mr. Robertson as to the type of policy that should be pursued, including centering

the target for net borrowed reserves at the present level of around $200 million. He asked, however, whether readopting the existing directive would not imply some further firming, rather than maintaining the present degree of firmness. He would not want to see net borrowed reserves deepen to $300 million, for example, unless the demand for bank credit strengthened.

Chairman Martin observed that it probably would be better to have net borrowed reserves fluctuate, depending on the strength of the pressures in the money market, rather than to have them held at any specific level. He did not believe it was possible, however, to spell out that sort of instruction in the directive. The problem was typical of those the Committee often faced in composing its directive. Perhaps Mr. Brimmer, as the newest member, would like to try his hand at working out such problems.

Mr. Daane commented that he thought the objective sought by Mr. Treiber's proposed amendment to the staff's draft directive was simply to avoid the kinks in the money market that might develop if there was too close allegiance to a target for net borrowed reserves. Perhaps that objective could be accomplished within the framework of the existing directive.

Mr. Swan said that Mr. Hickman's point seemed to be a valid one, since the existing directive called for further gradual reduction in reserve availability.

Mr. Robertson noted that the net borrowed reserve target he had recommended in suggesting that the existing directive be renewed was one fluctuating around $200 million--the present level--and moving up or down from that level depending on the strength of required reserves.

Chairman Martin said he doubted that monetary policy could be formulated as a series of still pictures. It was a moving stream, constantly flowing in one direction or the other, and to try to stop the stream could change the whole course of policy.

Mr. Hickman remarked that he had favored the recent firming actions. He did not want to overdo them, however, and did not favor further firming until the Committee had more time to assess developments. He was prepared to vote for readopting the existing directive if it was to be interpreted in the manner Mr. Robertson suggested.

Chairman Martin said it was clear to him that the Committee would not want to overdo firming action.

Mr. Treiber observed that the existing directive seemed workable to him in the light of the discussion around the table.

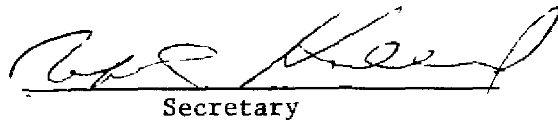
> Thereupon, upon motion duly made and seconded, and by unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following current economic policy directive:

The economic and financial developments reviewed at this meeting indicate that the domestic economy is expanding vigorously, with prices continuing to creep up and credit demands remaining strong. Our international payments continue in deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to help restore reasonable equilibrium in the country's balance of payments, by moderating the growth in the reserve base, bank credit, and the money supply.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to attaining some further gradual reduction in reserve availability.

It was agreed the next meeting of the Committee would be held on Tuesday, April 12, 1966, at 9:30 a.m.

Thereupon the meeting adjourned.



Secretary

ATTACHMENT A

CONFIDENTIAL (FR)

Drafts of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on March 22, 1966

Alternative A (no further change)

The economic and financial developments reviewed at this meeting indicate that the domestic economy is expanding vigorously, with prices rising further and credit demands remaining strong. Our international payments continue in deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to help restore reasonable equilibrium in the country's balance of payments, by maintaining moderate rates of growth in the reserve base, bank credit, and the money supply.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the present level of net reserve availability.

Alternative B (further gradual firming)

The economic and financial developments reviewed at this meeting indicate that the domestic economy is expanding vigorously, with prices rising further and credit demands remaining strong. Our international payments continue in deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to help restore reasonable equilibrium in the country's balance of payments, by moderating the growth in the reserve base, bank credit, and the money supply.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to attaining some further gradual reduction in net reserve availability.