MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, April 1, 1969, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman[1/]
Mr. Bopp
Mr. Brimmer
Mr. Clay
Mr. Coldwell
Mr. Daane
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Scanlon
Mr. Sherrill
Mr. Treiber, Alternate for Mr. Hayes

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

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

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

Mr. Sherman, Consultant, Board of Governors
Mr. Cardon, Assistant to the Board of Governors

Messrs. Coyne and Nichols, Special Assistants to the Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Wernick, Associate Adviser, Division of Research and Statistics, Board of Governors
Mr. Keir, Assistant Adviser, Division of Research and Statistics, Board of Governors
Mr. Bernard, Special Assistant, Office of the Secretary, Board of Governors
Miss Eaton, Open Market Secretariat Assistant, Office of the Secretary, Board of Governors

Mr. Black, First Vice President, Federal Reserve Bank of Richmond
Messrs. Parthemos, Jones, and Craven, Senior Vice Presidents of the Federal Reserve Banks of Richmond, St. Louis, and San Francisco, respectively
Mr. Brandt, Vice President of the Federal Reserve Bank of Atlanta
Mr. Kareken, Economic Adviser, Federal Reserve Bank of Minneapolis
Miss Beekel, Assistant Vice President and Economist, Federal Reserve Bank of Cleveland
Mr. Meek, Assistant Vice President, Federal Reserve Bank of New York
Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston

By unanimous vote, Mr. Robertson was elected Acting Chairman for the period until Chairman Martin entered the meeting.

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

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

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 4 through 26, 1969, and a supplemental report covering the period March 27 through 28, 1969. Copies of these reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Coombs said that the Treasury gold stock remained unchanged, and after a purchase of $50 million of gold from France, the Stabilization Fund now had $470 million on hand. In the London and Zurich markets, the gold price had come down to slightly less than $43 yesterday after the speculative flare-up earlier in March which had lifted the price to a record level of nearly $44. In recent months, the major speculative element in the gold market had been the outlook for the French franc. There had been worldwide concern that a forced devaluation of the franc might trigger a round of competitive devaluations and ultimately force either a gold embargo or an increase in the official price of gold by the United States. More directly, speculation against the franc by French residents had impinged directly on the Zurich market through illegal export of French bank notes for purchase of gold in Switzerland. Over the last few weeks, however, the market had been swinging to the view that the French Government might well succeed in getting through the current wage negotiations without undue damage, and it was now awaiting the outcome of a new test--the referendum scheduled for April 27, which General de Gaulle was treating as a vote of confidence. He thought, therefore, that barring some unexpected political or other development the gold market situation should remain reasonably calm for most of April.

Looking further ahead, Mr. Coombs remarked, most of the European central banks had the impression--which he shared--that the overhang in the gold market created by heavy official sales after the devaluation of sterling had now been pretty well immobilized in industrial uses and long-term investment holdings. It was significant that, even with the current stringency of credit and with interest rates in the Euro-dollar market at high levels, there had been no indication of any sizable dishoarding of gold. The market might well be moving into a period in which the price of gold would tend to react upward more sharply during periods of crisis, with correspondingly more dangerous effects on market confidence in currency parities. He thought the test of

On the exchange markets, Mr. Coombs continued, trading had been orderly in a reasonably quiet atmosphere. Sterling had been moving through its seasonally strong period, and since the beginning of the year the Bank of England had taken in several hundred million dollars, most of which had been used for repayment of debt to the International Monetary Fund. Meanwhile, British trade figures had continued to show a zigzag pattern, and that had done little to encourage confidence in the longer-term outlook. In addition to the unsettling effects of recurrent strikes and inflationary settlements, the market was now being subjected to a barrage of press stories urging a second devaluation or a shift to floating rate at the first favorable opportunity as the only way out. In the sixteen months since the devaluation of sterling the market had remained deeply suspicious of the tenability of the present parity, but it had accepted on a day-to-day basis the Government's apparent determination to continue the fight. It remained to be seen whether the recent press offensive would succeed in undermining the Government's commitment to the existing parity, as a similar campaign had done in the summer of 1967. At the moment the press campaign certainly was making Government's task more difficult.

In the case of France, Mr. Coombs said, as he had mentioned the current market view was that the French Government should be able to get through the present wage negotiations and avoid any new crisis until the referendum scheduled for April 27. The belief seemed to be growing that even if General de Gaulle should resign as a result of defeat on one of the issues in the referendum--for example, the proposed abolition of the French Senate--there might be an orderly transition to a new government under, say, Mr. Pompidou. The main financial question now facing France was how long the present straitjacket of exchange controls, which had succeeded in staving off devaluation, would remain acceptable to the French public--particularly to the business and financial community, for whom more than inconvenience was involved.

As to the mark, Mr. Coombs observed, during March the outflow of funds from Germany had moderately exceeded the runoff of forward swap commitments of the Federal Bank, so that German reserves had declined somewhat further. Attitudes toward the mark provided another illustration of the market's current tendency to focus on the short run. Most participants thought the mark would be revalued sooner or later, but they appeared to be accepting at face value the Government's statement that there would not be a revaluation at least until after the election next September. The current short-run confidence in the existing mark parity undoubtedly would begin to wear off as the election approached. By July and August, if not before, expectations of a change in policy after the election might well bring about a new round of speculation in marks with potentially serious implications for both sterling and the French franc.

Mr. Coombs reported that the other main recent development in the European exchange markets had been the actions taken by the various continental central banks to defend their domestic liquidity and credit situations from the strains generated by the sharp rise in U.S. bank borrowings from the Euro-dollar market. Over the past few months there had been a great many protests from the European central banks to the effect that Regulation Q, together with the absence of reserve requirements on bank takings from the Euro-dollar market, had been artificially intensifying the impact of U.S. credit policy on the Euro-dollar market. Mr. Daane and he had encountered some forceful expressions of such views at the February Basle meeting, and he understood that Mr. MacLaury had heard even stronger expressions at the March meeting.

The European central banks now seemed to be taking defensive action, but in an independent, uncoordinated way, Mr. Coombs said. In the last few weeks, the Netherlands Bank had instructed Dutch commercial banks to repatriate funds from the Euro-dollar market to strengthen their liquidity positions; the Bank of Italy had called on Italian banks to bring back

$800 million by the end of June; and the Swiss National Bank had refused to give swaps to its commercial banks at the end of March in order to induce a repatriation of funds from abroad and an injection of new liquidity into the Swiss banking system.

He was beginning to be concerned, Mr. Coombs continued, that such independent moves could develop into a broader pattern of intensive competition by European as well as American banks for a limited supply of Euro-dollar money. So far, the effects of that competition had been somewhat offset by the injection of new dollars into the Euro-dollar market through the deficit in the U.S. balance of payments and, on a smaller scale, through the continuing outflows from Germany. European central banks remained apprehensive, however, that a serious crunch in the Euro-dollar market might suddenly develop if intensified U.S. and European competition for Euro-dollars suddenly revealed some vulnerable positions. The situation could be particularly serious because the Euro-dollar market had become an increasingly important source of financing for industrial and commercial enterprises not only in Europe but in the whole world. One bankruptcy could attract a lot of attention, and if it led the European commercial banks that had been supplying funds to the market to reassess the credit risks they faced, the result might be a sudden scramble for liquidity. The chances of such a development were enhanced by the fact that no central bank had formal responsibility for the behavior of the Euro-dollar market; what had been accomplished in that connection had been done through informal central bank cooperation.

Mr. Coombs observed that it was hard to evaluate the degree of danger in the present situation because of the lack of information on the magnitudes and directions of flows, the nature of credit risks, and so forth. It was doubtful that anyone had a clear idea of just what had been happening in the market. But in his judgment the situation warranted close watching, and there was a need for contingency planning against the risk that a sudden crunch might develop.

Mr. Robertson noted that Mr. Brill had attended the March Basle meeting and asked whether he had any additional comments.

Mr. Brill remarked that one of the developments noted at the meeting was a warning by Dr. Blessing, in the course of an explanation of the situation in Germany, that some significant tightening of German monetary policy might be needed if the fiscal restraint measures being sought were not adopted. Recently, after the latest prime rate increase in the United States, the German Government had announced one measure of fiscal restraint that seemed to conform to the minimum Dr. Blessing had indicated was needed. Accordingly, the Federal Bank might not find it necessary to take much further tightening action, but that depended on the

Perhaps more important, Mr. Brill continued, and certainly more time consuming, was the discussion of the issue to which Mr. Coombs had referred--the impact on the European countries of U.S. bank borrowings in the Euro-dollar market. That issue was raised most pointedly by Governor Ansiaux of the Belgian National Bank. Except for the Swiss, the other participants all expressed concern and criticism, although in varying degree. In his judgment the most telling point probably was that made by Governor O'Brien of the Bank of England, who noted that U.S. banks were willing to pay almost any rate for marginal additions to their resources, but that the actions of U.S. banks at their margins were tending to force upward the general levels of rates in European money markets. At least superficially, the criticism seemed to stem from the notion that European countries were being forced to adopt monetary policies that were tighter than desirable from the domestic standpoint. It was not clear, however, whether that factor or the potential loss of reserves was really dominant in their thinking. In any case, the issue was of such great concern that all attempts to rechannel the discussion at the afternoon and evening meetings were unsuccessful.

Chairman Martin entered the room at this point and assumed the chair.

Mr. Coombs said he concurred in Mr. Brill's comments to add one observation on that subject. In his judgment the Europeans were not objecting to the general stance of U.S. monetary policy, which they considered necessary and appropriate. The focus of their concern was on what they considered to be the exaggerated impact of that policy on the Euro-dollar market.

In response to a question by Mr. Mitchell, Mr. Coombs said he thought that European central banks, with the possible exception of one or two in smaller countries, would be able to take the actions necessary to protect their financial markets from the pressures originating in the Euro-dollar market. The main danger he saw was that of a competitive struggle for Euro-dollars in which borrowers in the United States and the stronger European countries might eventually squeeze out more vulnerable borrowers. He did not know whether that would happen since, as he had indicated, good information on the market was lacking. However, although the risk was hard to evaluate it appeared to be sufficiently serious to warrant concern and planning.

Mr. Mitchell asked whether a large reflow from U.S. banks to the Euro-dollar market--say, on the order of $4 billion--would be required to relieve the concerns of the Europeans.

Mr. Coombs replied that the Europeans probably would be satisfied by a leveling off of the Euro-dollar liabilities of U.S. banks. In any case, they appeared to be more concerned about potential future developments than about those of the past. Their interest was in striking a happy medium, with the market neither saturated nor drained of funds.

In reply to another question by Mr. Mitchell, Mr. Coombs said that while good figures were not available, he had no doubt that the U.S. share of outstanding Euro-dollar liabilities had gone up recently.

Mr. Daane remarked that he would like to temper the impression left by the comments of Messrs. Brill and Coombs regarding European views on the Euro-dollar market. As he had sensed the situation on a visit to Europe last week, it was primarily in Belgium that real concern was being voiced and that a significant impact was being felt in domestic financial markets. Officials of a number of the other central banks had assured him that as far as their countries were concerned the Euro-dollar situation did not pose an immediate problem. With respect to the Bank of Italy's instruction to commercial banks to repatriate $800 million, the Italian monetary authorities had indicated to him that that action was related to the current political unsettlement in Italy and reflected a desire to avoid having a monetary disturbance contribute to the unsettlement. The Italian authorities said that they might well reduce the amount to be repatriated or perhaps even withdraw the instruction; accordingly, it was not definite that the inflow would actually come to $800 million. The potential no doubt existed for a competitive struggle for funds in the Euro-dollar market, but he did not think that the Italian action in itself was likely to precipitate such a struggle.

Mr. Brimmer observed that he was pleased to have the Special Manager urge the Committee to focus on the problems posed by recent Euro-dollar developments, about which some members had expressed concern from time to time. He had two specific questions. First, in connection with Mr. Coombs' suggestion that contingency planning be undertaken, he wondered whether the latter had in mind any specific actions that might be considered if it were decided that some action was needed. Secondly, he would be interested in knowing whether Mr. Coombs was aware of any indications that a substantial part of the supply of Euro-dollars was originating in the United States and reaching the market via Canada.

With respect to the first question, Mr. Coombs remarked that the Europeans had repeatedly suggested that either an increase in Regulation Q ceilings or the application of reserve requirements to Euro-dollar takings of U.S. banks would reduce the pressures on the Euro-dollar market. However, an evaluation of the merits of any specific proposals required an expert analysis of their domestic effects which he would find it difficult to make.

As to the second question, Mr. Coombs said he thought the high rates available in the Euro-dollar market probably were attracting corporate funds from the United States. Many U.S. corporations normally conducted sizable operations in the Euro-dollar market, and apparently many had leeway under the guidelines to transfer money directly to Europe. He did not know whether any flows were passing through Canada.

Mr. Morris asked whether an increase in the Federal Reserve discount rate would complicate the situation in the Euro-dollar market and lead to further defensive measures by European central banks.

Mr. Coombs replied that there probably would be at least some scattered increases in interest rates abroad in response to such an action. However, he found it hard to assess the likely magnitude of the reaction, partly because he was not sure of the extent to which a U.S. discount rate increase had already been discounted in Europe.

> By unanimous vote, the System open market transactions in foreign currencies during the period March 4 through 31, 1969, were approved, ratified, and confirmed.

Mr. Coombs then observed that there were no swap drawings maturing between now and the next meeting of the Committee requiring the attention of the Committee today. Both the Bank of England and the Bank of France had paid off the swap drawings made last summer, with the result that no individual drawings by the Bank of England were currently outstanding for more than seven months, and none by the Bank of France for more than five months. On the other hand, both lines had been in continuous use since last summer--from June 5, 1968, in the case of the Bank of France and from July 1, 1968, in the case of the Bank of England. Renewal of drawings by both the Bank of France and the Bank of England would come up for action at the next Committee meeting. If the drawings in question were renewed for three-month periods and not repaid in advance of maturity, the System's swap lines with the Bank of France and Bank of England would have been in continuous use for more than one year.

Mr. Coombs noted that paragraph 1D of the Committee's authorization for foreign currency operations provided that drawings on the swap lines should be fully liquidated after one full year of continuous use, unless the Committee, because of exceptional circumstances, specifically authorized a delay. While the situation could change considerably between now and the next meeting, it would appear at the moment that the Desk would have no practical alternative at the next meeting to recommending renewal of the French and British drawings, on the ground that insistence on their repayment would have serious undesirable consequences. He would also note that, since the System's credits to both the Bank of France and the Bank of England had been granted as part of multilateral credit packages, the Committee presumably would wish to take into account the attitudes of the other creditors. So far as he could gather, the European central banks saw little alternative to rolling over their credits to the Bank of France and the Bank of England until such time as recovery in the two countries or some funding operations permitted repayment.

Meanwhile, however, there might well be possibilities of chipping away at the British and French debt to the System by one means or another, Mr. Coombs said. The recent repayment at maturity of a $200 million British drawing was not accompanied by any debt repayment to other central bank creditors. That could, he thought, be fully justified on the grounds that the Federal Reserve and Treasury combined were currently extending a disproportionately high percentage of total short-term credits to the Bank of England. He thought the System could legitimately suggest that any further dollar inflows into the Bank of England should be devoted to paying down debt to the Federal Reserve and Treasury until the U.S. share of the total reverted to the traditional level of 35 to 40 per cent. He understood that the Treasury was prepared to take a firm line on the matter. Secondly, in May or June the British probably would manage to roll over a large part of their debt to the IMF and in the process the Bank of England might be able to draw $400-odd million of new money from the Fund. Here again, he thought the System could justify the position that a reasonable percentage--perhaps as much as 50 per cent--of that new Fund drawing should be used to pay down debt to the Federal Reserve.

In the case of the Bank of France, Mr. Coombs continued, it was his present understanding that the French Government did not intend in the foreseeable future to approach the IMF for a drawing of any part of the $1 billion available to them from that source for the purpose of paying off the swap debt now outstanding. However, in that case also there might well be possibilities for chipping away at the debt to the Federal Reserve, either through gold sales from time to time or through use of the sizable unpublicized reserves in the French stabilization fund. Another possibility would be a shift of French borrowing from the Federal Reserve to the continental central banks, if the reserve positions of the latter increased--as they might well do during the next six months in response to a continuing U.S. deficit, seasonal tourist receipts, and repatriation of funds by European commercial banks. As of the moment, French drafts upon the System's swap line were disproportionately high in relation to their takings from the continental central banks, and he thought that some reduction in the System's relative share would seem equitable to all concerned.

Mr. Mitchell remarked that he was a little surprised at the close association Mr. Coombs had made in his comments between drawings by the Banks of England and France. It had been his (Mr. Mitchell's) impression that of the two the Bank of France was in a far better position to repay its debts.

Mr. Coombs agreed that the French did have greater resources than the British that could be applied to debt repayment. The problem arose in the French case because of their present strong disinclination to draw on the Fund in the foreseeable future, since that left them with no alternative means of reducing debts other than utilizing their reserves. As he had indicated, however, he was hopeful that some of their debt to the System could be repaid by use of reserves or by shifting part of the outstandings to other central banks.

Mr. Mitchell then asked what the French understanding was about the terms on which they had access to Federal Reserve credit under the swap line.

Mr. Coombs replied that he thought the French considered drawings to be largely automatic, which was consistent with the position of the Committee since last May. He knew they were aware of the language in the authorization regarding repayment within one year except when the Committee specifically approved a delay, and in conversations with them he had touched lightly on that subject. However, he had not indicated that the System would necessarily require repayment at the end of one year. In his judgment such a statement would have been unwise; it undoubtedly would have damaged the System's relations with the French, which had improved considerably over the past few months.

Mr. Coldwell remarked that the Committee's deliberations at its next meeting on the matter in question would be facilitated if a memorandum on the subject were distributed in advance of the meeting.

Mr. Brimmer noted that at the previous meeting, after Mr. MacLaury had commented on the British drawings, it had been agreed that a memorandum should be prepared concerning possible alternatives to further use of the swap line by the Bank of England if the British should still need accommodation at the time the line had been in continuous use for one year. In his judgment the one-year limit was appropriate and he would be reluctant to have it breached without an effort to shift the obligation to the U.S. Treasury or to find some other means for repayment of the debt to the System.

Mr. Coombs observed that there had been informal discussions of that subject from time to time with the Treasury and with various European central banks. He did not see any real possibility of having the Treasury fund the British debts to the

System, and he thought the European central banks would not be willing to take them over in the form of guaranteed sterling holdings or by other means. More generally, he doubted that it would be advisable to try to fund the British debt to the System. By keeping that debt on a short-term basis, and rolling it over as necessary, strong pressure would be maintained on the British to find means for repayment, whereas funding might well result in a more relaxed attitude on their part.

Chairman Martin commented that it would be desirable to have a memorandum on the subject in question distributed before the next meeting. There was general agreement with the Chairman's comment.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering domestic open market operations for the period March 4 through 26, 1969, and a supplemental report covering March 27 through 31, 1969. Copies of both reports have been placed in the files of the Committee.

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

> Open market operations engendered firm conditions in the money market since the Committee last met and strong pressure was maintained on bank reserve positions. Divergent trends were evident in the securities markets. As the written reports indicate, considerable

upward rate pressure developed in the long-term capital markets, with rates on A-rated utility bonds reaching as high as 7.90 per cent. The municipal market was especially hard hit, with a large volume of cancellation and postponements. Last week, after long-term rates had risen by 1/4 of a percentage point or more, a fairly sharp recovery set in, partly reflecting persistent rumors about better prospects for peace in Vietnam--a factor that had not been important in the markets for some time. It is too early to tell whether this is much more than a temporary reaction. While the long-term markets are--at the moment--in relatively good technical position, considerable uncertainty remains about their ability to stand up to even a normal volume of demand in the municipal market, where demand is actually expected to be quite heavy in April, and to any increase in the volume of corporate offerings.

In contrast, rates on Treasury bills and intermediate-term Governments generally moved lower over the period, with the three-month Treasury bill rate moving well under 6 per cent for a time last week. As you know, the regular Treasury bill auction scheduled for yesterday was postponed until 11:30 a.m. this morning because of the national day of mourning occasioned by the death of former President Eisenhower. Yesterday, the market was expecting average issuing rates of 6.10 and 6.20 per cent for the new three- and six-month bills, respectively, compared to the 6.22 and 6.34 per cent averages established in the auction just before the last Committee meeting.

The substantial decline in bill rates was partly the result of technical factors--the relatively low dealer positions, bank demand over the quarterly statement date, Chicago demand in preparation for the April 1 Cook County tax date, and the payoff by the Treasury of $2 billion March tax-anticipation bills. But it also reflected the liquidity preferences of public funds and of a broad range of other investors who wanted to delay longer-term investment decisions. Whether or not the very recent relative strength in both the stock and bond markets indicates a fundamental shift in these preferences is far from clear. But it is clear that a sizable fund of nonbank liquidity has been built up, and investor sentiment will have a major impact on the yield curve in the weeks ahead.

The impact of monetary restraint on reserve aggregates and on bank deposits and credit is amply reflected in the written reports. It is also amply reflected in the ingenuity of banks in trying to avoid the constraints of Regulation Q. In addition to a still more intensive use of the Euro-dollar market, there has been increasing evidence of the exploration or use of other devices--such as the introduction of "documented discount notes," sales of assets to foreign branches, sales of commercial paper by a subsidiary or by a bank holding company, as well as various forms of link financing. While these devices are probably not yet large in volume, they are casting increasing doubt on the validity of the regular bank credit statistics that we follow. I know that the staff of the Board and of the New York Bank are working hard to keep on top of current developments, but it will require a concerted effort throughout the System if we are to keep up with, and understand, bank actions under continued firm monetary restraint.

Open market operations over the period were generally routine in nature. The March tax date passed quietly, and except for a few bad moments last Friday when it was unclear whether certain major banking centers would be open yesterday, so did the Cook County tax date. With the Treasury bill rate declining persistently, we avoided outright purchases of bills in the market in supplying reserves during the period. Two modest go-arounds to buy coupon issues were conducted early in the period, but repurchase agreements were used extensively to supply reserves while keeping banks on a short string.

While open market operations themselves caused no particular problems, interpretation of the credit proxy, including Euro-dollars, in light of the proviso clause was a more complicated affair. My basic understanding was that the proviso was to be implemented if the proxy adjusted for Euro-dollars approached the lower end of the 3 to 6 per cent annual rate of decline anticipated, provided that this implementation would not lead the market to believe that the System was moving away from a policy of restraint. By mid-month following the last Committee meeting, estimates of the proxy were already at the lower end of the range anticipated at the meeting. But with the Treasury bill rate declining, we decided not to implement the proviso so early in the month but to wait and see whether the estimates would be confirmed by subsequent developments. A somewhat smaller rate of decline was in fact estimated in the next week, mainly because Euro-dollar takings were larger than had been estimated. Last Friday, as you know, estimates indicated that the credit proxy was declining by something more than a 6 per cent annual rate in March. But with growing evidence that banks might be expanding lending in ways we were not measuring, with April estimates indicating a reversal of the trend, and with a new meeting of the Committee so near at hand, the proviso clause went unimplemented.

Looking ahead, the picture--even over the next four weeks--is no clearer than it usually is. Interest rate and credit developments will depend heavily on market sentiment and expectations, and I find it impossible to predict what may eventuate. There are many in the markets--particularly in banks--who are convinced that the Federal Reserve and the Administration mean business in stopping inflation, and there are many skeptics who are waiting to see what happens when there finally is some evidence that the program is getting results. Events will not only depend on private decisions--whether to stay short in the storm cellar or to go long, to go into the capital markets or into the banks, or to wait--but also on possible Federal Reserve actions. An increase in the discount rate has been largely discounted by the market, but it could have at least a temporary upward influence on interest rates. An increase in reserve requirements is somewhat harder to assess, depending on how strongly the Committee wants such an action to be confirmed or offset by open market operations. And an increase in Regulation Q ceilings would generally be interpreted, I believe, as a backing away of the Federal Reserve from restraint unless powerfully offset through the use of other instruments of policy. In any event, if other actions do eventuate in the near future, as suggested in alternative B of the directive,1/ I would expect that the Committee would want any overt evidence of a firmer monetary policy confirmed by open market

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

operations, with something like the money market conditions spelled out in the blue book.[1/]

As far as the Treasury is concerned, our current projections indicate that there will be a substantial cash squeeze just prior to the April tax date. Since Congress has passed the debt ceiling increase, no unusual recourse to System credit should be needed. In any event, we anticipate that the Treasury's balance at the Federal Reserve Banks will decline to near zero by mid-month and direct borrowing cannot be ruled out. At the end of the month the Treasury will be announcing a refunding of May and, presumably, June maturities--of which about $6 billion are held by the public--and any overt System action should bear this timetable in mind.

One final word, assuming that the Committee decides to adopt a proviso clause in the directive. I would hope that, in deciding whether or not to implement the proviso, the Committee would permit the Manager to take advantage of any information developed by the staff on new bank devices to adjust the credit proxy from its more or less

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1/ The report, "Money Market and Reserve Relationships," prepared for the Committee by the Board's staff. The money market conditions referred to were described in part as follow: "An increase in the discount rate to 6 per cent. . . . may tend to raise the whole interest rate structure somewhat, although it would appear that prevailing market interest rates have to some extent already discounted some such action. The 3-month bill rate may move up into a 6 - 6.30 per cent range. . . . A set of money market targets for open market operations consistent with maintaining the developing taut credit market conditions (as compared with such conditions absent a discount rate increase) would include a Federal funds rate around 7 per cent or slightly above, member bank borrowings centering around $1 billion, and net borrowed reserves in a $650 - $900 million range. . . . The announcement of an increase in reserve requirements--say a 1/2 point increase on either demand or time deposits--in conjunction with a discount rate rise would likely have, among other things, a more pronounced effect on expectations. Interest rates would probably rise somewhat more, although the odds on the 3-month bill rate moving above the upper end of the range (i.e., 6 - 6.30 per cent) are small, given the Federal funds rate specified (i.e., 7 per cent or slightly above)."

pristine form so as to more nearly represent a true picture of bank credit expansion. Implementation of the proviso--if called for in either direction--should also be conditioned by the general state of market sentiment.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period March 4 thought 31, 1969, were approved, ratified, and confirmed.

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

Mr. Partee made the following statement concerning economic developments:

The developments of the past four weeks seem once again to require a lifting of our sights on the prospective strength of business expansion this year. The most important news, of course, was the finding of the February Commerce-SEC survey that businesses are planning a 14 per cent increase in plant and equipment outlays for the year as a whole. But consumption also appears to be stronger than had been expected, reflecting in part a rebound in spending propensities following the rather sluggish sales experience of the Christmas season, and in part the continued buoyant trend of employment and incomes. Residential construction--both starts and activity--also has remained very high thus far, in the face of the rising cost and curtailed availability of funds.

The immediate result of all this is an indicated rise in GNP for the first quarter which is both larger in size and stronger in composition than we had been expecting. The staff estimate now is for an increase somewhat in excess of $15 billion, versus the $13.5 billion we were projecting four and eight weeks ago. Even more dramatic is an indicated rise of more than $18 billion in final sales--far more than had been anticipated earlier--with an associated reduction in the rate of business inventory accumulation. Smaller additions to stocks may have resulted in part from adjustments in production, as indicated by the recent slowing in the growth of over-all industrial output, but the rise in sales was probably a more important factor. Meanwhile, prices have continued to advance sharply, with the diffusion of increases among wholesale commodity groups unusually broad, and the unemployment rate has remained exceptionally low.

The pattern of developments I have described also suggests a significantly stronger GNP growth beyond the first quarter than we had projected in the February chart show. First, there is little remaining prospect or need for further inventory adjustment, given the strength in final sales and the already reduced rate of inventory accumulation. Second, the continued increase in capital spending, if realized, will provide an important source of self-generated demand which, in combination with its multiplier effects on income, should serve to lift final sales appreciably. Third, the sharp drop in the personal saving rate indicated for the first quarter could signal a return to the lower rates that prevailed prior to mid-1966, in which case consumption would continue to run higher relative to income than in recent quarters. Finally, with the demand situation stronger and cost pressures still intense, the price factor can be expected to continue adding substantially to dollar increases in GNP; we are now projecting only a very gradual decline in the deflator, to a 3-1/2 per cent annual rate in the fourth quarter.

In sum, the staff projection is now for a continuing pattern of GNP increases in the $15 billion range, averaging about one-fifth larger per quarter than had been projected in the February chart show. Growth in final sales can still be expected to slow this quarter, reflecting the effects on disposable income of retroactive payments on the surtax, a slowing in the capital spending uptrend, and the probable beginnings of the downturn in residential construction. But the effects of this on GNP growth may be minimal, since business should be willing to continue accumulating inventories at about the recent rate in reflection of good product demand. And after mid-year there is the threat of a resurgence in final sales, when retroactive tax payments are no longer a factor and the scheduled Federal pay raise takes effect. In the absence of a sudden drop in Vietnam military expenditures, such a resurgence is likely to be averted only if housing continues on a downward trend and if a moderate stretchout or cancellation of capital spending flows can be achieved.

It is worth noting that some economic projections in Washington show a significantly larger rise in the second-half GNP than does the Board staff version. We are assuming that the degree of monetary restraint in effect over recent months will be increasingly successful in curbing future outlays for housing, State and local construction, and business plant and equipment. As you all know, we have been expecting the downturn in housing for some months. Nothing much has happened as yet, but as interest rates rise and funds flows to the institutions moderate, a reversal seems increasingly likely. In the State-local area, numerous postponements and cancellations of bond issues in recent weeks should presage some cutbacks in construction programs, unless the needed funds can be raised soon. In the business capital spending area, too, there are indications that the availability of external funds may be an unusually sensitive consideration this year. A preliminary and confidential breakdown from the Commerce survey shows that, in manufacturing industries, the very large firms are planning only a 7 per cent increase in spending this year, while firms having total assets between $10 million and $100 million are planning a boost of 28 per cent.[1/] The medium-size firms presumably are more dependent on bank borrowing, and have fewer options for external financing, than the giant ones. In addition, of course, stretchouts in programs might well follow if the expansion in product markets can be held in reasonable check.

1/ A memorandum from Mr. Partee, entitled "Correction of Data Presented to FOMC on Business Capital Spending Plans," and dated April 4, 1969, was distributed to the Committee on April 7. A copy is appended as Attachment B.

> On balance, it seems to me clear that the underlying business situation remains excessively strong. Substantial increases in GNP are in prospect, and even on the staff assumption that policy restraints will be taking hold as the year progresses, curtailment in growth of real demand is too moderate to take much pressure off the labor force this year or to prevent substantial continuing increases in prices. In large part, what we are now experiencing is the inevitable lag before more restrictive policies take effect on the real economy. But we have no very good means of assessing the relative strength of the eventual reaction, and it may well be that the current ebullience of the economic situation signals the need for a posture of still greater restraint in over-all public policy. President Nixon has just announced his intention to hold Federal expenditures in fiscal 1970 "significantly" below the January Budget projection, though of course any resulting cutbacks can be expected to take effect only gradually as the year progresses. The question is whether something more is desirable, to become visible more promptly, in monetary policy too.

Mr. Hickman commended Mr. Partee for an excellent presentation but noted that he himself had been inclined toward a somewhat less bullish appraisal of the underlying economic situation. A recent forecast prepared by the staff at the Cleveland Bank suggested that over-all expansion in GNP would be close to that expected by the Board staff in both the first and second quarters. However, the composition of GNP growth according to the Cleveland Bank estimates implied less strength, with personal consumption expenditures lower and inventory accumulation higher than in the Board staff's projection.

Mr. Partee commented that GNP growth would depend importantly on what happened to the personal saving rate. As he had noted in his statement, there was a preliminary indication of a sharp drop in the saving rate in the first quarter--apparently to a level below that incorporated in the Cleveland Bank's projection. If the lower saving rate persisted, consumption would continue to run higher relative to income than in other recent quarters.

Mr. Brimmer observed that, if his recollection was correct, capital expenditures by the large firms in the Commerce-SEC survey represented a sizable proportion of total outlays for business plant and equipment. Thus, even if those firms were planning to increase their capital spending by only 7 per cent while medium-size firms were contemplating a 28 per cent increase, the large firms would still account for a major share of the 1969 increase in capital outlays.

Mr. Partee indicated that his impression also was that large corporations would account for over half of the total increase in capital expenditures in the manufacturing industries. At the other extreme small firms would contribute relatively little to the over-all increase, since those firms were planning an expansion of only 6 per cent in their capital outlays. He wanted to caution that the staff did not have much experience for judging the implications or accuracy of the breakdown of planned expenditures by size of firms, since this was only the second year such a breakdown had been available. Nevertheless, the 28 per cent increase planned by medium-size firms was impressively large; it would follow a year in which over-all growth in plant and equipment outlays had been small.

Mr. Brimmer said he gathered from the green book[1/] and from Mr. Partee's statement that the staff expected the actual increase in capital expenditures in 1969 to fall somewhat short of the 14 per cent expansion indicated by the Commerce-SEC survey.

Mr. Partee replied that, while he did not want to be held to any specific figure, the odds appeared good that such a shortfall would occur. For purposes of the projection, the green book assumed that growth in capital outlays would be about 12 per cent in 1969. That shortfall had been introduced because it was felt that continued monetary restraint would have at least a marginal impact on some expenditures and some firms. The planned 28 per cent increase in plant and equipment spending by medium-size corporations seemed to him to reinforce that possibility, since such corporations would be more affected than giant corporations by more restrictive bank lending policies and tight conditions in the capital markets.

Mr. Morris indicated that it was not clear to him what monetary policy assumptions were incorporated in the staff

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

projection--whether, for example, the staff was assuming a continuation of the current degree of monetary restraint.

Mr. Partee said that in developing its projection for the year the staff was still assuming that bank credit would expand at an annual rate of around 5 per cent--the same assumption used for the chart show in February. Interest rates, of course, were likely to average higher than was projected in February and in that respect one could say monetary conditions were tighter than assumed earlier. In addition, monetary expansion had been running somewhat less in the first quarter than had been assumed earlier. But no change in policy had been directed by the Committee since the February meeting, and he felt that the staff should not introduce changes in policy assumptions for the purposes of the projections incorporated in regular green book presentations.

Mr. Morris remarked that in his opinion the staff was in fact assuming a change from the current monetary policy, since the bank credit proxy would have to expand at a 7 per cent annual rate over the last three quarters of the year in order for the growth rate to average 5 per cent for the year as a whole.

Mr. Partee replied that the staff had not, in fact, adjusted for the shortfall in bank credit in the first quarter and was still using a growth rate of about 5 to 6 per cent for the balance of the year. At the same time, the linkages in that area were so imprecise that he did not want to press the importance of achieving that figure too far. Mr. Brill would address himself more fully to that subject in his presentation.

Mr. Brill made the following statement regarding financial developments:

> I have discovered, to my chagrin, that it is not safe to turn your back on this economy for a day, let alone to go out of the country for a couple of weeks. In this brief absence, my colleagues on the staff have pumped more inflation into their projection of the economy, but at the same time monetary policy has deepened the contraction in bank credit. And despite the heightened attention to monetary quantities these days, many--perhaps most--financial market participants are looking at miniscule monetary and credit numbers and still questioning whether there is real financial restraint. I'm having a hard time adjusting to this topsy-turvy situation. Let me see this morning if I can sort out the issues.
>
> First, as to the course of the economy, the inventory adjustment has come too soon to be the restraining factor we had hoped for. There is a big difference between an economy in which the rate of inventory accumulation is reduced because sales have been slack and one in which inventory targets are not reached because final sales have been stronger than anticipated. Recent developments have elements of both, but I'm afraid too much of the latter, i.e., too much strength in final sales. This is not a background against which one might expect businessmen to restrain production growth or capacity enlargement, or to be induced to hold back on price increases. And the new staff projection reflects this, with more real growth and a higher deflator through the year than the target levels set forth for the Committee's consideration two months ago.
>
> At that time--early February--it seemed to us that the target real variables--a deflator stepping down to a 3 per cent rate by year-end and real growth averaging a 2 per cent annual rate over the second half of the year--might be achieved with a policy stance that

resulted in a bank credit growth averaging about 5 per cent for the year as a whole, and a somewhat lower pace for the first half of the year. Given the greater-than-anticipated strength that has been emerging in the real economy, it seems likely to require more monetary restraint than that to achieve these targets for the real economy. We haven't had time to do a detailed flow-of-funds exercise to derive more precise price level and quantity flow objectives, but some rough calculations suggest that lowering our sights to a bank credit expansion over the first half of the year at an annual rate of somewhere between 2 and 3 per cent might be appropriate.

The trouble is that we are far below this objective so far. Bank credit, as measured by the proxy adjusted to include Euro-dollar borrowing, contracted at over a 2 per cent annual rate in the first quarter; even on an end-of-month basis, credit growth was at a piddling 1 per cent annual rate. The reduction in credit growth rates from the fourth quarter of 1968 to the first quarter of 1969, as measured by the proxy, represented a sharper quarterly downshift than at any other time in the entire postwar period. The conclusion I would draw from the financial flow data--confirmed also by financial price data, particularly the rapid rise in long-term interest rates--is that even with the stronger GNP outlook, we have already set in train all the monetary restraint the current and prospective economic situation needs--probably more than is needed.

Unfortunately, few financial market participants and even fewer members of the business community appear to believe this, and open-mouth policy doesn't seem to be making much of a dent in their apparently intransigent views. Perhaps there is some justification for their skepticism. The impact of restricted credit availability and exceptionally high borrowing costs has been distributed unevenly among groups of lenders and among groups of credit seekers. The impact has been most marked on States and municipalities, whose ability to cope with rapidly escalating market rates is limited by interest ceilings and other inhibitions, and whose principal market for debt instruments--commercial banks--has nigh vanished. Commercial bank holdings of municipal securities expanded at about a 5 per cent annual rate in the first quarter of this year, compared with a 21 per cent rate in the fourth quarter of last year and 15 per cent for last year as a whole. As a result, the volume of new issues marketed by State and local governments has dropped sharply this past quarter, to levels seen recently only during the height of the 1966 crunch.

But business corporations have been able to maintain the volume of new security issues so far this year at fairly close to the pace of late 1968. And for the first quarter, business loan growth at banks was up at a 14 per cent annual rate, faster than in any quarter last year. Although loan expansion in March was at a much reduced pace, this may have reflected the exceptionally large volume of business borrowing in January and February, some of it probably in anticipation of further hikes in the prime rate.

Among lender groups, at least those for which we have any fairly current estimates, the thrift institutions appear to have held up to monetary restraint better than the commercial banks. Growth rates of savings inflows to the thrift institutions did drop somewhat over the first quarter, from about a 6 per cent annual rate to about a 5 per cent rate, but this has been far less than the reduction in commercial bank consumer-type time and savings deposits inflows. The better-than-expected experience has encouraged the thrift institutions to step up new commitment volume in order to capture the high level of current mortgage yields.

Among banks, the impact of restraint has been diverse, with apparently more bite at larger banks than at medium-size and smaller banks. The partial--and seasonally unadjusted--data available indicate that at weekly reporting member banks, loan performance in January and February was about the same as in comparable months of other recent years, but that there was much larger liquidation of U.S. Government and other securities. At non-weekly reporting banks--which on average are smaller than the weekly reporters--loan performance was stronger than in recent years, and these banks were also able to take advantage of the high yields prevailing in municipal markets to add more than usual amounts to their municipal portfolios.

Given the spotty incidence of restraint, it is not surprising that one hears such widely conflicting reports about the efficacy of monetary policy to date. Everyone seems to know someone who has gotten credit with no sweat. This sort of gossip should not obscure what every set of statistics is telling us about the credit situation: over all, credit availability has been sharply reduced and credit costs are sharply higher. Nonetheless, gossip cannot be dismissed out-of-hand. If the business community and its financial counselors are persuaded that monetary restraint has no bite, they will act on their convictions and persist in inflationary expansion programs.

This, then, is the potential dilemma I see for policy: how to avoid being stampeded into over-doing restraint, while still convincing the public that we mean business. I call it only a potential dilemma because, for a change, the forces that dictate the timing and amplitude of Treasury financing needs are working in our favor. Given the repayment of Treasury debt expected in coming months--indeed, starting toward the end of this month, after mid-April tax payments swell the Treasury's coffers--the System is likely to have to take action, in any event, to absorb reserves and thereby keep the bill rate from dropping too far. This action could be a discount rate increase, for the visibility it affords, accompanied by confirming open market operations to offset the downward pressures on bill rates.

There is a slight technical hangup. Downward pressures on bill rates are not expected to develop until after the mid-month tax date, and in the intervening weeks, banks and short-term money markets are expected to come under some upward pressure from tax borrowing, cash rundowns, and the already enlarged dealer positions in short bills.

Acting on the discount rate soon, therefore, runs the risk of exacerbating these upward rate pressures, with the added danger that allowing any subsidence in bill rates after the peak pressure period might be misconstrued as an easing of policy, as was the case in January. On balance, however, I would not think that the risks flowing from a temporary bulge in bill rates are too grave. Both banks and market operators will be looking towards the easing in pressure expected to emerge in two to three weeks. Indeed, there is a risk that, with so many expecting a discount rate action, we may get more easing in rates than is desirable if such an action is delayed. Moreover, in a few days we will be fairly well past the critical phase of the interest crediting period at thrift institutions.

Our fearless estimators indicate that, even with a discount rate increase, but with some help from Euro-dollar flows, we may be able to moderate the bank credit contraction and possibly even to wind up with a slight increase in the proxy for the month. While the rate levels likely to emerge after a discount rate increase to, say, 6 per cent, would probably result in continued large CD runoffs for much of the month, we could probably wait a bit to see whether the downward pressure emerging on bill rates after mid-month relieves us of a confrontation with that distasteful issue--Regulation Q ceilings. I don't mean to sound complacent about the effects of an increase in discount rates within the next week or two, but I think that the margin for serious error in such an action is not unbearably wide.

I am less enamored today, however, of the idea of incorporating a reserve requirement increase in a new restraint package. There would be advantages: if the effective date is properly timed, it would ease the Desk's problems in absorbing reserves, and it could be used to restructure the impact of restraint within the banking system to reach those classes of banks that seem to have felt the impact least thus far. But the combined announcement effect of a discount rate hike and a reserve requirement increase might be greater than is desired, particularly in the next two-week interval, and might force us into sizable open market operations to moderate the speed of market rate adjustments. This tool of monetary policy might prove more useful a bit later on, when the System has to fight stronger downward rate pressures emanating from the large Treasury debt repayment in prospect.

I apologize, Mr. Chairman, for having been so lengthy this morning, but the situation is both intricate and critical, with many considerations to be weighed. My assessment leads me to recommend the policy alternative B outlined in the blue book--a discount rate increase to 6 per cent in the next few days, with open market operations geared to keeping the funds rate around 7 per cent or slightly above, and member bank borrowings ranging around $1 billion. I would wait before taking any further restraining steps, to assess the effects of this action on financial markets and credit flows.

Mr. Maisel remarked that he did not fully understand Mr. Brill's prescriptions for policy. Early in his statement Mr. Brill had suggested that it would be desirable to achieve a rate of expansion in the bank credit proxy during the next three months that would result in growth at an annual rate of 2 or 3 per cent for the first half as a whole, allowing for the contraction at a 2 per cent rate that had occurred in the first quarter. Later, however, after commenting on the need to affect expectations, Mr. Brill had suggested a near-term increase in the discount rate and confirming open market operations. Since such action would almost certainly reduce the possibility of obtaining the credit growth Mr. Brill had indicated was desirable, it was not clear to him (Mr. Maisel) how Mr. Brill had arrived at his policy recommendation for the short run.

Mr. Brill replied that the problem, as he saw it, was one of reconciling the conflicting needs of the present situation. In his judgment the short-run need was for a signal of greater monetary restraint, and he thought the expected nature of market forces in April would make such a signal--in the form of a discount rate increase--feasible without exerting too much pressure on markets. According to the staff's projections, even with such an action and confirming open market operations, there might not be further contraction in the credit proxy in April, and possibly some slight credit growth. While it would be much less than the 2 to 6 per cent growth rate projected on the assumption of no change in policy, it was a step in the right direction following the decline in the bank credit proxy in the first quarter. Later, the Committee could formulate its decisions regarding open market policy in light of the actual reaction to the discount rate increase. His longer-run prescription implied that policy should be somewhat more accommodative of bank credit growth in May and June than in April.

Mr. Hickman commented that while growth in bank credit at virtually a zero rate in April might be a step in the right direction, it was not much of a step. He would prefer the 2 to 6 per cent growth rate projected under the assumption of no policy change.

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

> In this world of full-employment aspirations, inflationary pressures, and fluid international capital movements it is becoming harder and harder to judge a country's balance of payments position, either currently or prospectively--and never more so than at a time when the flow of foreign trade has been disturbed by suspension of unloadings and loadings at the ports. The British have had a lot of experience with these difficulties of factual knowledge, analysis, and prediction; and we are certainly having our difficulties now. There will be a good deal of guesswork in all I say today.

First, I think we can safely assume that the extremely large payments deficit we experienced in the quarter just ended will not be characteristic of the rest of the year. In order to keep our comparisons with past and future periods from being dominated either by changes in the amounts of special official financing or by the large changes we have been experiencing in Euro-dollar inflows, I shall use as a measure of our balance of payments on current account and other capital transactions the balance financed by the sum of official reserve transactions and increases in U.S. liabilities to commercial banks abroad. On this basis, in the first quarter there was a deficit in the range of \$1-1/2 to \$2 billion. We can safely assume that for the year 1969 we will not have a deficit four times that large.

The main consideration to support this judgment is that for various reasons the resumption of import activity, after the strike ended in New York and most other ports, was quicker than the resumption of export movements. We know that this was so in February, and we suspect that in March the arrivals and unloadings of postponed imports were still as large as the departures of postponed exports. The trade balance in the first quarter, instead of being near zero as we would have expected without the longshoremen's strike, may have been a deficit of around \$1/2 billion. If it had not been for that, the over-all deficit would have been less--in the \$1 to \$1-1/2 billion range.

We do not have the information we would want to evaluate such a figure as this, but at least we can take cognizance of the fact that some extraordinary inflows of corporate funds occurred just before the year-end and of the possibility--or even probability--that some return outflow to foreign subsidiaries occurred during the first quarter. There had been a seasonally adjusted surplus of over \$1/2 billion in the fourth quarter on the basis I am using--counting above the line the current account plus capital other than commercial bank balances and official reserve movements--and if it had not been for the port strike's initial and anticipatory effects the surplus might even have reached \$3/4 billion. It may be reasonable to combine this adjusted fourth-quarter surplus with the adjusted first-quarter deficit. If we do this we get what looks pretty good in comparison with 1967 or early 1968, a rather small six-month deficit around $1/2 billion--that is, at an annual rate around $1 billion.

When we make any comparison of the balance of payments position in recent months with what it was a year or so ago, we would do well to try to avoid either the exhilaration the fourth-quarter surplus figures gave us or the depression the first-quarter deficit could conceivably generate. In the first half of 1968, the deficit on the basis I am using was at an annual rate of $4 billion. To have moved from that to a very much smaller rate of underlying deficit in the past six months is cause for thankfulness and wonder, but no stronger emotions. The identifiable elements of improvement, as you know, have lain principally in the capital accounts, the largest being the growth of the foreign inflow to the U.S. stock market. In addition, the unidentified "errors and omissions" of the balance of payments accounts have shifted from negative, until about the middle of last year, to positive since then--for more or less unidentifiable reasons.

Two months ago we gave you a balance of payments projection for the year 1969 in which the deficit on the basis I am using this morning--that is, without counting Euro-dollar inflows as reducing the deficit--would be $3 billion, only moderately less than the $4 billion annual rate level in the first half of last year. Taking the past six months as a whole, we have so far been doing much better than that, if the guesses I have been giving you are anywhere near right. Nevertheless, I am not prepared to say now that the February projection was too pessimistic, over all. It may have leaned toward pessimism as to the continuation of large inflows of equity capital, but the view we gave then of the trade balance now looks grossly overoptimistic.

The revision that is being made in views about domestic prospects for 1969 requires a revision of our projection of imports more than proportionate to the upward revision in the projection of aggregate demand. In an economy in which rapid price advances are to continue, while domestic inventory investment continues at an average sort of pace and does not drop off temporarily to subnormal levels, we can not hope, as we did in February, for a very slow import rise to bring imports well below their trend by the latter part of the year. Instead we must expect merchandise imports to rise at least in line with GNP, taking what comfort we can from the thought that this will still be a good deal less than the 15 per cent average annual increase in the value of merchandise imports over the past five years. A revision of this sort, plus a minor writedown of agricultural exports as a consequence of the port strike, would cut the projected trade surplus for 1969--which in February we set at about $2 billion--back down to something like $1/2 billion, to be described only as infinitesimal progress from zero.

If the present underlying payments position is not as bad as it looks on the surface, and if the outlook for the current account is gloomier than we had hoped, what can be said about the official settlements surplus which the Euro-dollar inflow was giving us in January and again in March? Unexpected, and unsettling--to say the least. I would like to make two brief comments and raise a third question.

First, U.S. corporate funds may have helped to feed Euro-dollar supplies during the first quarter. If so, both the liquidity deficit and the Euro-dollar inflow were thereby enlarged. Note, however, that the official settlements surplus itself is a firm fact, reflecting substantial flows out of other currencies into Euro-dollars.

Second, the funds attracted out of other currencies by high Euro-dollar interest rates are now coming less from the commercial banking systems in major European surplus countries--Germany and Italy--than was the case in January. The pull is now more widespread, and it has been causing increases in interest rates in many national money and credit markets. However, these rate increases have been greater in countries whose balances of payments are in deficit or only precariously in surplus, smaller in the hard-core surplus countries of Germany, Japan, and Italy. This is as it should be. Partly it reflects conscious differences of policy in the various countries. While Germany and Italy are acting to hold down outflows of banking funds, they are doing so in ways calculated to keep their interest rates low enough to foster domestic expansion and to encourage long-term capital outflows.

The question that naturally arises is whether the impact of the Euro-dollar pull on European interest rates is undesirable and, if so, is it avoidable? Or is it unavoidable, and really not a bad thing? Without trying to explore at all the issue of avoidability through U.S. action, I would like to throw out a thought or two on the issue of desirability. European countries do have it in their power to hold down their own interest rates if it seems important to them to do so. The objection is made that this might cost them reserves. From the U.S. point of view, if countries can afford to give up reserves we are glad to gain them; if they cannot afford the loss, they must look for remedies. In some cases the remedy of tighter monetary policy will seem undesirable. Other broader remedies are international cooperation to get the SDR activated and to eliminate international payments surpluses as well as deficits. If the method by which we are balancing--or overbalancing--our international accounts serves to call attention to these needs for international cooperation, it can not be wholly undesirable.

Chairman Martin commented that the staff presentations had effectively pointed up the problems facing the System at present. He had had conversations recently with the officials of the Administration concerning the Federal Budget. As Mr. Partee had reported, a "significant" reduction was planned in fiscal 1970 expenditures from the estimate contained in the January Budget document. However, he (Chairman Martin) did not know precisely how large a reduction would be effected.

Before the go-around began this morning, the Chairman continued, he would take a moment to bring the Committee up to date with respect to monetary policy instruments other than open market operations. Since the previous meeting of the Committee the directors of eight Reserve Banks had proposed increases in discount rates from the present 5-1/2 per cent level. Six Reserve Banks had submitted discount rates of 6 per cent and one a rate of 6-1/4 per cent; and earlier one Bank had submitted a 5-3/4 per cent rate. The latter two Banks had informally given indication of their willingness to vote for a 6 per cent rate if the Board was not prepared to approve the rates they had established initially.

While a number of factors had led the Board to defer action on discount rates, the Chairman said, he expected that the Board would be weighing such action later this week. A possible increase in member bank reserve requirements probably would also be considered at the same time. On the latter issue, there were questions not only of whether an increase was desirable but also regarding the appropriate size and structure of any increase made. Finally, since all the policy instruments were interrelated, consideration would also have to be given to Regulation Q ceilings. While final authority in those areas rested with the Board, the Committee's practice of discussing all System policy instruments had been useful in facilitating their coordination. Accordingly, he hoped that everyone would feel free to comment on the various policy instruments in the course of the go-around this morning.

The Chairman then invited Mr. Brimmer to comment on the status of the Government's balance of payments program.

Mr. Brimmer indicated that, while he had some idea of the main dimensions of the contemplated balance of payments program, he was not certain how it would be worked out in detail. In essence, the Administration was considering "some relaxation"--to use their expression--in major elements of the program.

Mr. Brimmer said he would not be surprised if the Administration recommended an extension of the interest equalization tax (IET) and at the same time proposed a reduction in the tax rate. He thought that that would be an appropriate move under present and prospective monetary conditions; it would suggest responsiveness on the part of the Administration to changing circumstances.

With respect to the Department of Commerce program of direct investment control, Mr. Brimmer continued, it appeared likely that the Administration would permit some increase in the minimum level of investment beneath which companies were not subject to the program and its reporting requirements. The current cutoff was $200,000. How high the minimum should be raised was one of the questions still under debate; increases to $600,000 and to $1 million had been suggested. If, as seemed more likely, the cutoff was set at $1 million, the total permissible direct investment outflow would be raised from the neighborhood of $2-3/4 billion in 1968--the actual net outflow was much less--to somewhat over $3 billion in 1969, without taking account of the possible use of large carry forwards from 1968.

Mr. Brimmer said he did not know whether the Administration would recommend other changes. It was his impression, however, that the two he had outlined were the only major changes under consideration.

Mr. Brimmer indicated that the Board was recommending some modifications in the Federal Reserve program. One recommendation was that banks should be permitted to choose a ceiling equal to 1-1/2 per cent of their total assets at the end of 1968 if that would give them more leeway. That proposal would add some $400 million to the total ceiling, with virtually all of the added leeway concentrated at small- and medium-size banks. Another recommendation would be to continue deducting term loan repayments by borrowers in continental Western Europe from the ceiling. The result would be a reduction of $100 million to $150 million in the over-all ceiling of large banks, partially offsetting the increase of around $400 million under the first recommendation. Since banks could carry forward the unused leeway of $475 million existing at the end of 1968, they would have an over-all leeway of somewhat under $1 billion in 1969. On the basis of past experience banks would not be expected to use all of that leeway.

As the Committee would recall, Mr. Brimmer continued, nonbank financial institutions had been requested to reduce their holdings of covered assets during 1968 to 95 per cent of an adjusted end-of-1967 base. Restoration to 100 per cent of the base was being recommended. The change was proposed basically for technical and administrative reasons and it was expected to increase the leeway of those institutions by some $45 million.

Mr. Brimmer said he wanted to stress that the Board's recommendations involved essentially a restoration of the program of November 1967. At that time the Board had announced guidelines which would have permitted an increase in ceilings to levels of roughly the same order of magnitude as those presently under consideration. The amount of additional leeway proposed in November 1967 had been cut back by two-thirds in conjunction with the President's more stringent balance of payments program announced on January 1, 1968. He would emphasize that the additional leeway of around $400 million being proposed was relatively small in terms of the total ceiling of $9.7 billion at the end of 1968. He had been counseling against any major relaxation in the program on the ground that the outlook for the balance of payments, however measured, did not justify such a relaxation.

Chairman Martin then said that he would like to add a few observations bearing on possible monetary policy actions. In his judgment the time for decisions was close. With the latest increase in the prime rate to 7-1/2 per cent, the existing 5-1/2 per cent discount rate could be viewed as a subsidy rate. Moreover, the problem of a "credibility gap" facing the System had become serious. When he had testified before the Senate Banking and Currency Committee last week he had distributed a table indicating, among other things, that growth in the money supply had slowed markedly between the fourth quarter of 1968 and the first quarter of 1969. It was interesting to note that various sophisticated observers had been unimpressed by the statistics shown in the table, and had implied by their questions that they doubted whether the recent performance of the monetary aggregates would be maintained in coming months. Perhaps their attitude reflected the fact that various System projections had not worked out well in the recent period. In any case, the System had to face up to that problem.

Mr. Morris asked whether the Administration was giving serious consideration to a suspension of the 7 per cent investment tax credit. In his judgment that, more than any other feasible action, was likely to be interpreted by the business community as evidence of a serious determination to contain inflationary pressures.

Chairman Martin replied that he did not know the Administration's view on that matter It was his personal view that it would be a mistake to suspend the investment tax credit

Chairman Martin then called for the go-around of comments and views on economic conditions and monetary policy, beginning with Mr. Treiber, who commented as follows:

> The economy is vigorous and inflationary psychology is strong. There are some signs of a slowing down in the rate of economic advance, but the signs are modest. Retail sales are lagging behind the rest of the economy, probably because of the surtax, but they show more strength than was previously thought to exist. The rate of growth of industrial production has slowed, possibly reflecting a slower growth in inventories.
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> But the latest Government survey of business plant and equipment spending shows a clear upgrading of plans since late last year. Housing starts and permits in January and February point to greater near-term strength in residential construction than had been projected. And new orders for durable goods rose sharply in February. There was an unusually large rise in employment in January and February. Unemployment remained at the very low rate of 3.3 per cent.
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> Recent price developments show no improvement. Indeed, advances in wholesale industrial prices seem to have accelerated.
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> Despite the projection by the outgoing Administration in January of a modest budgetary surplus for the fiscal year ending June 30, 1969, it is not at all clear that there will be a surplus. A continuation of the strong economic advance could push up receipts to bring a surplus. The big question is what will happen to expenditures. For the next fiscal year the prospects of avoiding a deficit are even more cloudy.
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> The nub of a compensatory fiscal policy is a budgetary deficit in a period in which a substantial portion of the nation's resources is idle, and a budgetary surplus in a period in which excessive demand presses on available resources. In practice it has been much easier to achieve a deficit than a surplus. In the current situation of excessive demand, fiscal policy should provide a substantial surplus.
>
> Our over-all balance of payments position has worsened. Some of the year-end capital inflows apparently has been reversed, and there have been large payments for imports following the end of the dock strike. With strong

inflationary pressures at home, it is hard to see our international balance of trade making the contribution it should to our payments balance.

On the official reserve transactions basis, however, there was a sizable surplus in March caused by a new surge of Euro-dollar takings by U.S. banks from their foreign branches. Indeed, several foreign central banks have suffered heavy dollar losses as a result of the rise in the demand for U.S. dollars in foreign exchange markets.

The impact of monetary restraint on the banking system is becoming increasingly evident. Since the first of the year, bank liquidity has declined significantly; there has been little change in bank credit, and growth in the money supply has been moderate. These developments should not be disturbing. Indeed, they are welcome. They should be viewed as a needed correction following a period of excessive credit expansion. The danger of an excessive shrinkage of bank credit and the money supply seems minimal at this time.

The large banks have been under pressure because of the Regulation Q ceilings. There have been substantial runoffs of large-denomination CD's. The banks, as might be expected, have sought in various ways to offset such losses. The most common and effective route has been an increase in Euro-dollar takings with a consequently high Euro-dollar rate--now around 8-1/2 per cent on three- and six-month maturities--and upward pressure on other money market rates abroad.

Another mechanism that has been used to some extent is the sale by a bank of some of its loans, either outright or subject to a repurchase agreement, to foreign branches or to third parties. A one-bank holding company can arrange the sale of commercial paper by the holding company or a nonbank subsidiary and use the proceeds to buy loans from the bank affiliate.

It is apparent that the banks are struggling to devise new ways to get funds to meet loan demand. As new ways of acquiring funds are expanded, there could be a blurring of the meaning of various statistical series.

The increase in the prime rate from 7 to 7-1/2 per cent on March 17 brought that rate to a record high. Market reaction was quite mild. The two-point spread between the prime rate and the discount rate is large.

On the other hand, U.S. Treasury bill rates are only about 1/2 percentage point higher than the discount rate; this spread or a greater spread has existed for more than three months.

The strength of the economy and the prevailing inflationary psychology, in my opinion, counsel some visible evidence of a modest tightening of credit policy. An increase in the discount rate from 5-1/2 to 6 per cent would provide such evidence and would bring the discount rate into better alignment with market rates. It is not likely to be viewed as a drastic turn in the screw to increase monetary pressure.

I would not recommend a major change in open market policy. Open market operations, however, should confirm the discount rate increase. Such a confirmation might be evidenced by (a) a Federal funds rate in the 6-3/4 to 7-1/4 per cent range; (b) member bank borrowing in the $800 million to $1 billion range, or perhaps a bit higher; (c) net borrowed reserves in the $600 million to $900 million range; and (d) the three-month Treasury bill rate in the 6 to 6-1/4 per cent range. As for the directive, I consider the first paragraph of the staff's draft to be satisfactory, and I favor alternative B for the second paragraph.

Closely related to the discount rate and open market policy are Regulation Q ceilings, Euro-dollar problems, and reserve requirements.

An increase in the ceilings on large-denomination CD's under Regulation Q presumably would enable the banks to acquire more funds, or at least lose fewer funds, through the CD route. The pressure on banks to liquidate securities in a weak market would be reduced, and the banks would feel that they were in a better position to meet their high loan demand. Stated another way, disintermediation might be reduced or intermediation increased. Bank credit would be increased, but it is difficult to say what would be the effect on total credit. An increase in such Q ceilings, standing alone, would probably be interpreted as an act of monetary ease. It would be likely to reinforce the current inflationary psychology. I believe that domestic considerations do not call for an increase in Q ceilings.

Euro-dollar takings have sometimes been referred to as an escape from Regulations D and Q, and it has been suggested that some kind of a reserve requirement be imposed on such takings. But such takings have not materially adversely affected the ability of the System to pursue its policy of monetary restraint. One argument for such restriction is the matter of equity among banks, for only the larger banks have foreign branches. In addition to domestic considerations, there is the impact of Euro-dollar takings on foreign money and exchange markets mentioned by Mr. Coombs. He suggests careful watching and contingency planning. This raises serious questions about the need for policy tools that could be used on short notice should there arise an urgent need to reduce the strains in the Euro-dollar market. Fortunately, we don't have to reach a conclusion today.

This is a complex matter that deserves our careful attention. We have done some thinking about possible ways of dampening the borrowing of Euro-dollars by head offices of U.S. banks. We have considered four alternatives: (1) imposition of reserve requirements--perhaps at the time deposit rate--on loans by a foreign branch to its head office; (2) imposition of a dollar ceiling on loans by a foreign branch to its head office; (3) imposition of very high reserve requirements--perhaps as high as 100 per cent--on such loans above the amount outstanding on a particular date; and (4) a "voluntary" agreement with banks with foreign branches to achieve a similar effect. Another approach that might find favor with European central banks would be an increase in Regulation Q ceilings on large-denomination CD's.

None of these alternatives is without drawbacks--some of them serious. I have already expressed the view that a change in Regulation Q is not desirable at the present time for domestic reasons. But, if for urgent international reasons, action on our part is required, we may have to choose between undesirable alternatives.

If, in the future, some upward adjustment in the Q ceilings is called for, some other Federal Reserve action would seem desirable to offset the interpretation of the Q ceiling increase as an act of monetary ease. Such action might include an increase in reserve requirements. On balance, it seems to us that the present situation does not counsel an increase in the Q ceilings. Nor is it possible to form a judgment as to when, if at all, such action might be called for.

> Thus, it would seem wise to hold in abeyance any change in reserve requirements for possible future use as an offset to an increase in Q ceilings, or as an additional measure of restraint.
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> To summarize, I would favor an increase of 1/2 percentage point in the discount rate and adoption of alternative B of the draft directives. I would not favor at this time any change in Regulation Q ceilings or reserve requirements. Nor would I favor the use at this time of any new tool to curtail Euro-dollar takings.

Mr. Francis commented that Chairman Martin's statement before the Senate Committee on Banking and Currency on March 25 had included an excellent policy prescription. He believed that the Chairman had been correct in saying that there could and would be lower market rates of interest once inflationary expectations subsided, and that the immediate task was to maintain a restrictive monetary policy stance in order to bring that inflation under control.

Mr. Francis noted that substantial progress had been made recently in reducing monetary stimulus. Good evidence of that progress was shown by the expansion of the monetary base at a 2.7 per cent annual rate in the last three months compared with a 6 per cent rise in the previous year, and a reduction in the annual rate of expansion of money to 2 per cent since December, also down from a 6 per cent rise in the previous year. Those were very desirable developments and he wanted to commend the Desk for the actions which brought them about.

Mr. Francis recalled that a year ago and again late last summer growth of the money supply had also slowed for a few months. In each of those cases, however, rapid rates of expansion had been resumed after a brief pause and before the slowing could have had much impact on economic activity. In view of the continued excessive demands for goods and services and further inflationary pressures, he was pleased by the apparent resolve to take those actions necessary to avoid resumption of rapid expansion in the monetary aggregates.

The shift in monetary actions had been significant in recent months, Mr. Francis said. He viewed 2 to 3 per cent annual growth rates in money and base money--following two years of growth at rates of over 6 per cent in those measures--as probably a sufficient degree of restraint, provided those slower growth rates were maintained for a sufficient duration. The recent rate of monetary expansion was slightly less than the average for the 1961 to 1964 period when the economy successfully moved from recession to high employment. Now, with full employment, expectations of further inflation, and accompanying high interest rates, slower monetary growth than in the 1961-64 period might be appropriate.

Mr. Francis indicated that in his view the Desk should manage the System's holdings of Government securities so as to provide a volume of member bank reserves and a monetary base which would foster a 1 to 3 per cent annual growth rate of money over the next few months, and which, hopefully, would result in an average rate of expansion at near the recent 2 per cent rate over a substantial period. He hoped that the Committee would not be anxious to ease the stance of policy when it began to observe signs of slowing of total spending in the economy, but he would also caution against becoming impatient for the effects of the present slower rate of monetary growth to be observed in total spending and price inflation.

Mr. Francis thought that pursuit of adequate restraint would probably be facilitated by relaxation of Regulation Q in line with the general upward movement of interest rates in the past six months. Permitting a reflow of funds through the banks would not, in and of itself, be stimulative; and it would relieve the extraordinary stringency in a particular segment of the credit markets, a stringency which might become so great as to dissuade the Committee from continuing its restraint on marginal credit and money creation. Relaxation of Regulation Q would also permit a more efficient allocation of the limited supply of funds.

Mr. Francis said he continued to feel that the discount rate should be increased by 1/2 of a percentage point, and he hoped that reserve requirements would remain unchanged.

Mr. Kimbrel remarked that he was happy to report one particular bit of good news about the Sixth District. The Georgia legislature had passed a bill to do away with non-par banking in the State, and in the past week the bill had been signed into law. It would become effective on January 1, 1970, and would then add about 200 banks to the par list. With that addition, and with Florida's elimination of non-par banking last January, almost 90 per cent of all Sixth District banks would have par status by January 1970.

Turning to other matters, Mr. Kimbrel recalled that he had indicated at the last meeting that, as far as the Sixth District was concerned, policy restraint had not bitten very deeply. Since then, from what he could tell, the situation had not changed a great deal. District banks were still making loans in exceptionally heavy volume. Lending in general and lending to businesses in particular had shown no sign of slowing down in recent weeks. The continuing strength in lending applied to both the larger and the smaller banks.

Mr. Kimbrel said that a few of the District's larger regional money market banks now had loan-deposit ratios in the mid-80's and those banks seemed very close to the point where they would have to turn down more customers and trim their applications more severely. But that did not appear to be so for the smaller banks. Even while increasing their loans, they had continued to add to their investments and had even stepped up their sales of Federal funds. The principal sellers of Federal funds had been country banks in Florida, which was one area in particular where banks seemed quite comfortable. Even the largest banks in Florida had loan-deposit ratios that were down in the 50's and 60's and some of them had been reluctant in going along with the recent increase in the prime rate.

The District's savings and loan associations likewise were not under severe pressure, Mr. Kimbrel continued. Their savings flows so far this year were ahead of what they had been in the same period of 1968. Year-over-year increases in their mortgage lending also were running higher and so were their commitment levels. One prominent Florida savings and loan association even announced a reduction in its rate on prime mortgage loans because of heavy savings inflows. Thus, as far as the Sixth District was concerned, he judged that neither banks as a group nor the savings and loan associations were under serious strain.

Evidently, Mr. Kimbrel continued, that situation was generally true for the country as a whole, although there might be local differences. He recognized, of course, that the circumstances at the larger money market banks were different and that the most recent national loan figures had not been quite as strong as in the Sixth District. But on the whole the squeeze seemed more limited than in 1966. Furthermore, it appeared that, not only in the Sixth District but throughout the country, banks were coming up with techniques that gave them some relief from credit restraint. He thought banker ingenuity could be trusted to develop still others. Therefore, the System had some additional amount of elbow room within which to operate.

All of that was to the good, Mr. Kimbrel said, because he certainly was not in favor of another credit crunch. But at the same time he thought the System might be compelled to make some additional tightening moves at this juncture in light of the most recent figures on prices, the balance of payments, and the behavior of the economy as a whole.

From among the tools available, Mr. Kimbrel remarked, he hoped that any changes in Regulation Q ceilings could be delayed at this time. A modest increase in reserve requirements still appealed to him because such an increase would reach the smaller banks which had been relatively untouched by the System's past policy actions. He also thought the discount rate should be raised by 1/2 of a percentage point, not only because the present rate was obviously far behind the market but because the increase might help to stiffen bill rates and to reaffirm the System's firm commitment to continue the fight against inflation. If reserve requirements and the discount rate were increased, with no change in Regulation Q ceilings, then a change in open market operations, along the lines of those suggested in conjunction with alternative B of the draft directives, would seem appropriate.

Mr. Bopp remarked that progress continued to be made in slowing down growth in bank credit and the money supply, and signs of restraint were increasing in financial markets, a recent example being the increase in the prime rate. But even under the most optimistic reading, policy had had only modest success thus far in dampening inflationary psychology and slowing down the overheated economy.

In fact, Mr. Bopp said, his hopes that results of policy were beginning to show up in the real economy had received somewhat of a setback since the last meeting. The staff of the Philadelphia Bank now estimated the first-quarter increase in GNP to be about the same as for the fourth quarter of 1968. While consumer spending in February maintained January's strong pace, the capital goods sector was taking on the appearance of 1964-1966, when plant and equipment spending played such a key role in stimulating over-all economic activity. The expected step-up in inventory accumulation during the current quarter suggested that manufacturers were planning for a strong second half. All of that added up to continued pressure on prices and did not bode well for the trade surplus and the balance of payments.

Mr. Bopp commented there had been virtually no developments since the Committee's last meeting to alter the view of a strong Third District economy. Unemployment rates were low and employment continued to expand. The Philadelphia Bank's business outlook survey indicated that manufacturers had become increasingly optimistic about the near term, and a high percentage of respondents anticipated a strong and inflationary economy six months from now.

Although he was impatient with the slow reaction to policy measures already taken, Mr. Bopp said, he continued to remind himself that lags were to be expected. Consequently, he believed that a move to greater restraint through open market operations would be a mistake.

However, Mr. Bopp added, at their last meeting the directors of the Philadelphia Bank had approved his recommendation for an increase in the discount rate. He believed that an increase now would serve two purposes. Most important, it would clearly confirm the System's ongoing program of restraint at a time when inflationary expectations continued apparently unabated. Second, it would narrow the disparities between the discount rate and market rates. The ultimate impact of the change on spending decisions probably would be relatively small, if only because the market had been expecting it for several weeks. Nevertheless, it would be a visible signal of the System's intention at a time when doubt still existed that the System meant business. He would not recommend at this time a change in reserve requirements or in Regulation Q ceilings. With financial markets as taut as they were, open market operations should be the major policy tool because of their flexibility.

Mr. Bopp indicated that he favored alternative B of the draft directives.

Mr. Hickman commented that the flow of business news since the Committee's last meeting had been disappointing--at least to those who continued to search for signs that the inflationary boom was abating. Residential construction continued stronger than expected; despite scattered layoffs, labor markets remained extremely tight; and the latest capital spending survey was cause for deep concern.

Mr. Hickman noted that the few signs of moderation observed since the last meeting continued to be concentrated in the consumer sector. Consumer spending in real terms was not much changed from a year ago, and the full force of the surtax on disposable income would not be felt until the tax date this month. Nevertheless, the gain in GNP in the first quarter would probably come close to the gain in the fourth quarter. Consumer prices continued to rise inexorably at an annual rate of 4-1/2 per cent, and wholesale industrial prices had shot up at an annual rate of 6 per cent between December and March.

All of those developments supported those who favored more monetary restraint rather than less, Mr. Hickman said, and he had to admit that he had recently, on occasion, begun to doubt the validity of his prescription of moderate restraint. On the other hand, all of the financial indicators clearly pointed to extremely tight conditions in the money and capital markets, at times bordering almost on the disorderly. The declines in both versions of the credit proxy in the first quarter and postwar record levels of interest rates and bond yields all pointed in the direction of extreme, if not excessive, restraint.

Mr. Hickman said he was convinced that the key to the current situation was the relationship of Treasury bill rates to Regulation Q ceilings. After the three-month bill rate dropped below 6 per cent two weeks ago, the major New York banks were apparently able to stabilize the outstanding volume of their CD's, but without attracting any new money. The New York banks had evidently advised their large national customers to draw down on credit lines with major banks outside New York, which had caused extreme tightness at some of the larger banks in the Fourth District. Local banks in the District reported that they had cut back sharply on new commitments, particularly for new construction; and that, even so, they would soon be forced to liquidate substantial amounts of marketable obligations.

Mr. Hickman thought that if the three-month bill rate held steady within a range of 5-3/4 to 6 per cent the New York banks should be able to retain CD's, stabilize their loan portfolios, and moderate pressure on banks outside New York. On the other hand, he thought that if the rate rose much above 6 per cent a credit crunch was highly likely.

Current short-term rate relationships appeared to be about right, Mr. Hickman continued, and he strongly recommended that the Committee maintain them and give the present degree of monetary restraint a chance to work out over the next two or three months. He favored no change in the discount rate at this time. He also favored no change in Regulation Q ceilings because the present ceilings were biting and that was what the System wanted. He also recommended no change in reserve requirements at this time. Alternative A of the staff's draft directives came out at about the right target and he favored that alternative.

Mr. Sherrill remarked that while the lag in the effects of recent firming actions by the System were somewhat frustrating, he thought there was no doubt that those effects were now in train. The large money market banks, which as recently as a month ago had not been under much pressure, were now feeling the effects of monetary restraint. They were turning to the interior banks to help resolve their problems, and in so doing were spreading the effects of restraint to all banks. He thought it was reasonable to rely on that market process, and accordingly he would not favor a reserve requirement action designed especially to soak up liquidity at outlying banks. In his judgment the money market banks should be prepared to absorb pressures in periods of restraint, particularly since they enjoyed certain advantages in other periods.

Mr. Sherrill observed that he agreed with much that Mr. Treiber had said regarding the use of the various policy instruments. He favored an increase in the discount rate to 6 per cent, since such an action would enhance the System's ability to hold bill rates up in a range that would avoid any suggestion of easing. He would not favor an increase in Regulation Q ceilings at this time. He had already commented on a particular type of reserve requirement action; but in general he would be inclined to withhold reserve requirement action for possible use as a counterbalance to an increase in Q ceilings, in the event the latter became necessary. For the directive he favored alternative B.

Mr. Brimmer said he was pleased to have the benefit today of the views of the Reserve Bank Presidents regarding possible use of the various System policy instruments, but did not plan to comment at this time on the types of policy actions the Board would be considering later. With respect to open market operations, he thought it would be wise for the Committee to anticipate that the Board would take firming action of some type, and accordingly he considered alternative B appropriate for the directive.

Mr. Brimmer then referred to Mr. Holmes' comments regarding the various new devices banks were using, such as sales of assets to foreign branches and sales of commercial paper by a subsidiary. Since banks with access to such devices could employ them to deflect the effects of the System's policy of restraint, he was not surprised that knowledgeable observers were unimpressed with the slowing of growth in the monetary aggregates in the first quarter. In his judgment the Board should focus on the question of whether any regulatory actions were called for by the developments of the type in question. In that connection the Board had had certain changes in Regulation D under consideration for some time, and he hoped that decisions could be taken shortly.

Mr. Brimmer noted that he was disturbed by the current economic situation as portrayed by the staff. Apparently, monetary policy was having very little impact on demands for resources. Although he thought that monetary policy should do what it could, he doubted that it could have the necessary effect. In particular, it would prove difficult for monetary policy to slow the rapid increases in plant and equipment outlays that businesses were currently planning. The best course probably would be a firmer fiscal policy, not simply involving cutbacks in Federal expenditures but including higher taxes to reduce the volume of claims on resources originating in the private sector.

Nevertheless, Mr. Brimmer said, he did not agree with Mr. Morris that it would be desirable to suspend the investment tax credit; he was impressed by the administrative difficulties the Treasury was still experiencing in connection with the earlier suspension and restoration of the tax credit. The better procedure, in his judgment, would be to increase the surtax on corporate and personal incomes.

Turning back to open market policy, Mr. Brimmer remarked that he thought the Committee should be prepared to reinforce whatever additional policy actions the Board might take. As he had indicated, he favored alternative B for the directive.

Mr. Maisel said it should be clear, as it had been from the previous statements, that today the Committee was not concerned primarily with a question of interpreting the current economic situation nor of the ultimate goals of monetary policy. The members all agreed demand was great and that spending was higher than projected or desirable; and few were worried that monetary policy would squeeze too much demand out of the economy in the intermediate policy period the Committee should be considering.

Rather than arguing about the state of the economy or goals, Mr. Maisel continued, the Committee must be concerned with the much more difficult question of what monetary policy strategy should be used to reach its ultimate goals. How could monetary policy best do its part in reducing demands that were likely to lead to higher prices over some future period such as the next two years? How could a viable intermediate-term monetary policy be maintained?

It had been clear for some time, Mr. Maisel observed, that both within the Committee and among the System's supporters and critics there had been major splits on that question. It now appeared that a time for decision had arrived.

Mr. Maisel hoped that the System would not alter its basic monetary strategy, at least as he had understood it. It should stick with the policy of maintaining a slow but adequate growth in the monetary aggregates. Specifically, the System's policy should be one of maintaining the growth of the monetary aggregates somewhat below normal for a considerable period of time in order that it might obtain the greatest anti-inflationary impact possible from monetary policy. Such a strategy of a steady noninflationary growth in the monetary aggregates was based on an assumption that monetary policy worked with considerable lags and that it was the average of the monetary variables over a medium-term period such as three to nine months that was important in influencing the economy.

Mr. Maisel said he thought he had detected two opposite possible strategies in the prior discussion. One seemed to assume that the money and credit markets should be squeezed as hard as possible on the assumption that such squeezing would lower specific types of demand. It seemed to assume that the Federal Reserve should use as its goal the amount of bank lending, or some similar variable, whether from banks' own funds or as a broker to business. A goal of trying to curtail bank lending to business was a possible one. He thought it had been properly used in 1966--contrary to the view of those who believed it to have been a crunch--when it meshed with the whole Government's strategy. However, he did not think the System should adopt such a goal at this time. Officials of the new Administration had made clear in nearly every speech on the subject that they thought such a goal would be a mistake. They had been publicly critical of the 1966 experience. They had made clear that they wanted to attempt a gradualist approach to the ultimate goal of price stability. They had repeatedly stated their hope that the Federal Reserve would cooperate in such an approach.

A second type of goal which had emerged, Mr. Maisel remarked, was the idea that the Federal Reserve should attempt to operate directly on psychology or directly on final demand. It was not clear whether it was the very short-run market psychology that was at stake--as Mr. Brill seemed to indicate--or whether it was the psychology of the final spenders.

There were three primary reasons why he would reject those last two strategies, Mr. Maisel said. In the first place, he thought that the System had to hold constantly in mind the long lag in the impact of monetary policy. If it attempted to change monetary policy frequently in the light of current psychology or recent spending estimates, it was too likely to over-shoot or under-shoot its target. It would search like a poorly regulated servomechanism.

Secondly, Mr. Maisel believed that psychology was not a critical factor in real spending decisions. It was the availability and cost of credit as well as the ability to sell goods that primarily influenced spending decisions. Psychological expectations were too ephemeral to make a logical goal for monetary policy. Finally, he gave considerable weight to the publicly expressed view of the new Administration. National goals and national priorities when expressed by the President and his Cabinet should be considered as of major importance and should be given a heavy weight by the Federal Reserve in determining its own goals and strategy.

Based on all of those considerations, Mr. Maisel observed, he would prefer alternative A for the directive. He would not want to change policy unless it appeared that the current level of the money market variables was leading to too rapid a growth in the monetary aggregates. In actuality, the opposite seemed to be the case. He would prefer not to change policy at this time until the Committee had had sufficient time to judge the efficacy of its current stance. He would let the Treasury bill rate fall into the 5.80 to 5.90 per cent range and would not push the other variables up in order to hold the bill rate at higher levels.

With respect to the proviso, Mr. Maisel hoped that the Manager would not consider it in effect unless the rate of bank credit growth went above the 6 per cent rate shown as one extreme of the range given in the blue book in conjunction with alternative A. He did not believe that the Manager should attempt to adjust and alter the proxy for other types of bank activity except for Euro-dollars. If the System believed banks acting as brokers interfered with monetary policy, it should attempt to handle that problem directly. It should be very clear as to how and why it was acting, however, before it decided that it wanted to expand its activity outside the traditional area of

Federal Reserve System concern with the creation of money and bank credit.

Mr. Daane remarked that, as the members of the Committee knew, he had been consistently concerned with the timing, as well as the character, of any overt move toward further restraint. He had counseled persistent firmness and waiting a bit to allow time for the seeming impact the System was having on the monetary aggregates to show through in other ways. He had felt all along that maintaining existing Regulation Q ceilings was an integral part of the System's restrictive efforts; and he had been reluctant to make a move that would precipitate a potentially counterproductive increase in those ceilings.

If he could lay aside the psychological overtones both at home and abroad, and their implications, Mr. Daane said, he would continue to favor waiting the situation out. But he did not think the System could ignore the existing inflationary psychology and its pervasiveness. Therefore, it seemed to him that the time had come for concerted System action, involving coordinated use of all of the policy instruments, not including changing Regulation Q ceilings.

The proximate basis for such action, in Mr. Daane's judgment, was the clear and compelling need for the System to intensify its efforts to control an inflation that had gotten away from it and that was feeding upon itself in terms of expectations. It was imperative that the System do what it could to counter those inflationary forces and expectations.

But his view as to that imperative had been reinforced by his visit in Europe last week, Mr. Daane continued. As he sensed the views of foreign officials in leading European countries, they were genuinely concerned over the seeming ineffectiveness of the System's policies in controlling inflation and in achieving sustainable balance of payments equilibrium. Parenthetically, he would make two comments: First, he thought that the performance of the U.S. balance of payments--even seasonally adjusted for Mr. Hersey--had been structurally disappointing, to say the least, and discomfiting; and second, in an open session in Europe last week one of the most knowledgeable European observers had said that he had "given up" on the United States in terms of its ability to solve its inflation and balance of payments problems.

Against that background, and with a liberalization of U.S. balance of payments controls imminent, Mr. Daane thought the System had to make an overt move to demonstrate by deed as well as by word its determination to defend the dollar. While that was desirable in its own right it would provide an important side benefit in strengthening the hand of the United States as it strove to bring about an early and large activation of Special Drawing

Rights as a key step in strengthening the international monetary system.

Mr. Daane remarked that he had long felt that meetings of the Committee afforded a unique opportunity for a free and frank interchange of views regarding all of the System's instruments of policy. For his part, therefore, he was glad to take advantage of the opportunity to lay his views on the table for more general consideration. As he saw it, from the standpoint of both the domestic and international financial responsibilities of the System, which of necessity were closely interrelated, and in this instance coincided as to objectives and policies, he would support: First, an increase in the discount rate to 6 per cent; second, a moderate across-the-board increase in reserve requirements--although he was somewhat less certain of the timing of that action and recognized that the case made by Messrs. Brill and Treiber had considerable merit; third, holding the Regulation Q ceilings where they were at the moment; and fourth, validating those actions through appropriate coordinate open market operations. Therefore, for the directive he would accept alternative B, but would favor changing the words "maintaining firm" conditions in money and short-term credit markets to "achieving firmer" conditions.

Finally, Mr. Daane said, he would agree that it was the better part of valor to watch Euro-dollar developments closely but he would not take special action at this time. As he had indicated earlier today, the concerns in Europe were uneven. They ranged from a German view that developments were, in their words, "facilitating" their internal policies, to the British and Dutch views of the impact as not significant, and to a very real concern in Belgium. In general, however, he would accept Mr. Hersey's point that other countries were not helpless to take measures of their own, and that the United States should not be overly generous toward their desires to add to reserves continually. In sum, he would not do anything about Euro-dollars at the moment but would keep developments under surveillance.

Mr. Mitchell observed that he agreed with most of Mr. Daane's conclusions. He would add that in his judgment the System could not and should not ignore the matter of market psychology. While it was true that a particular psychology was likely to be dissipated within two or three months if not supported by actual developments, he did not see why the System should tolerate its undesirable effects in the interim.

Mr. Mitchell said he was satisfied with the recent behavior of the monetary aggregates. He thought there was enough monetary restraint in train at present, and as Mr. Brill had suggested, perhaps too much. Nevertheless, the problem of psychology remained. In his opinion, an increase in the discount rate to 6 per cent, by itself, would be ineffectual in coping with that problem. But he thought the announcement of both a discount rate change and an increase in reserve requirements would have a considerable impact on the attitudes of bank customers. In his judgment it was not so much the banks but their customers--and perhaps also stock market investors--whose attitudes had to be changed. While the policy measures he favored would not add much net monetary restraint, they nevertheless should have useful consequences.

Mr. Mitchell noted that he disagreed with Mr. Daane with respect to Regulation Q. He thought the ceilings should be raised on large-denomination CD's with maturities of 180 days and over, or perhaps of one year and over. Such a step would put banks in a position to avoid a crunch. At the same time, since banks would be committing themselves to pay high rates for long-term funds, they were not likely to make use of the higher ceilings except in cases of real need.

Moreover, Mr. Mitchell continued, after hearing reports from bankers about all the new devices being used to avoid the constraints of Regulation Q, like Mr. Holmes he was beginning to be a little worried. An increase in Q ceilings on long-term CD's would be helpful in reducing the pressure to adopt such devices. He did not know how important they had become, and he would not be particularly concerned if the amounts involved were small and the period for which they were likely to be used was only a few months. However, he suspected that there would be a concerted effort to employ such devices; and that that, in turn, would postpone the time when monetary policy would be operating effectively. He did not think Regulation Q action of the type he favored would be interpreted as a signal of monetary easing.

Mr. Mitchell said he had given some thought to the question of the amount of friction introduced by the process of disintermediation--that is, the amount of monetary restraint involved in the shift of funds out of banks and into direct market investments. It was his opinion that the process did introduce a fair amount of restraint, partly because of the borrowers who depended wholly or mainly on banks as a source of credit. Nevertheless, taking everything into account--including the attitude of European central banks--he thought it would be well to provide some relief from the present Q ceilings to banks. In the absence of such action, the banks were likely to increase their borrowings at the discount window. He favored alternative B for the directive.

Mr. Black remarked that the boom was continuing in the economy of the Fifth District and in the country as a whole. There was little new information regarding the District of significance for monetary policy, but the Richmond Bank's survey respondents and other grass roots contacts seemed even more confident than at the time of the Committee's last meeting that the District economy would remain strong. The only significant sign of moderation was the persistent sluggishness in several important sectors of the textile industry.

At the national level, Mr. Black continued, signs of moderation were considerably less pronounced than was the case a month ago. Since much of the restraining influence of the anticipated turn-around in the Federal budget had already been experienced, the new estimates of consumer outlays and the February figure on personal income growth were a distinct disappointment. Coupled with the February gain in new orders for durable goods and the latest survey of business capital spending plans, those developments suggested little real progress in the System's efforts to combat the prevailing inflationary psychology. While he had expected prices to move up, the rate of increase in the past two months had been both surprising and disheartening.

In the financial area, Mr. Black observed, markets appeared to have taken the latest prime rate hike in stride and, while interest rates were unusually high, funds seemed to be moving more freely than in late February and early March. The recovery in stock prices last week seemed to have been associated chiefly with the bullish tone of the February business news and perhaps also with diminished confidence in the System's ability to contain the boom. But despite last week's developments in the bond and stock markets, he thought that a high degree of uncertainty continued to dominate underlying market psychology and he expected a persisting tendency for many investors to stay on the sidelines. With the Treasury retiring debt, that might make it difficult, especially after mid-April, for the Desk to maintain a bill rate range that kept the pressure on banks. He believed that the best way to meet that problem was by raising the discount rate to 6 per cent. In his view an increase in reserve requirements would be unduly harsh, and a relaxation in Regulation Q ceilings would cost the System its control over bank credit.

Despite the more bullish tone of the latest business data, Mr. Black said, he still felt that it would be a mistake to keep bank credit growth at a zero or negative rate for any sustained period. He would prefer to see growth resume at an annual rate of perhaps 2 to 3 per cent in the weeks ahead. The blue book projections suggested that such growth in the proxy adjusted for Euro-dollars might be consistent with a discount rate of 6 per cent, although he believed that the determining factor here would be the behavior of bill rates. For that reason, he favored giving the Desk considerable latitude to seek a bill rate range which would produce that result. He favored alternative B of the draft directives.

Mr. Clay commented that the national economy continued to expand at a pace beyond earlier expectations. It also continued to expand at a rate beyond the growth in available resources, notably manpower, and prices exhibited a strong inflationary trend. Expectations of further marked price inflationary developments were pervasive in business and financial circles as well as among the public generally. Perhaps that attitude was conditioned by views and assurances that nothing must happen that would result in recession or even in much increase in unemployment. At the same time, a clear agreement on peace would moderate inflationary expectations.

Monetary policy had brought substantial financial response thus far, Mr. Clay said, but the desired results of monetary and fiscal policy were not yet apparent in the real economy. Persistent pursuit of the restrictive monetary policy of recent months would intensify those financial pressures and should scale down demand for goods and services in various markets. Whether the resulting financial stringency might become greater than was appropriate before such real objectives were achieved remained to be seen. For the present, no relaxation was called for; neither would it be constructive for the business and financial community to observe any evidence of a lessening of monetary restraint.

Mr. Clay thought one action that was in order was an increase of 1/2 percentage point in the Federal Reserve discount rate. The current discount rate was out of line with the Federal funds rate and other money market rates. It also was inappropriate for discount window administration. As more banks felt liquidity pressures, that factor was of increasing importance. Furthermore, a discount rate increase would be a symbol of the continuing resoluteness of Federal Reserve monetary restraint. An increase of 1/2 percentage point should not be a disturbance to the money and capital markets; it probably had been largely discounted. That was not to say that it might not reverse the recent decline in Treasury bill rates. On the other hand, an increase of 1/4 percentage point would be insufficient and probably confusing to the business world and the financial markets.

Mr. Clay indicated that monetary policy for the period ahead could be carried out by open market operations and an increase in the discount rate. Modification of Regulation Q ceilings would be an easing action and would compromise the policy of restraint that the System had been pursuing. Moreover, it probably would be widely interpreted by a skeptical public as a backing away from the System's posture of monetary restraint.

If Regulation Q ceilings were modified, Mr. Clay said, some offsetting restraining action would be necessary. One possibility would be an adjustment in open market operations, but an increase in member bank reserve requirements probably would be needed. Apart from an easing of Regulation Q, an increase in member bank reserve requirements would not seem to be required.

If the Board of Governors took any other monetary action without much delay, Mr. Clay thought it would be logical to coordinate the discount rate change with such a step. Barring other Board action, the increase in the discount rate was desirable promptly.

Mr. Clay added that financial indicators associated with open market operations and the discount rate increase might include a Treasury bill rate of 6 to 6.30 per cent, a Federal funds rate around 7 per cent, and member bank borrowing in a range of $850 million to $1,050 million. Alternative B of the draft policy directives appeared to be satisfactory.

Mr. Scanlon said that in the interest of time he would summarize the statement he had prepared on economic activity and financial conditions in the Seventh District, and would submit the full text for inclusion in the record. He then summarized the following statement:

> Recent evidence indicates that the economy in the Seventh District retains a strong upward momentum. Labor supplies remain extremely tight and upward price pressures have not abated. Expected increases in employment, inventories, and prices are widespread.

Except for passenger cars and farm equipment, for which output schedules have been reduced, most industries find current demand for their products and services to be greater than a year ago, and greater than had been expected at the start of 1969. Increasingly, it appears that machinery and equipment producers are faced with a new boom. Delivery lead times for producers of equipment and components--such as gears, bearings, drives, and clutches--have lengthened further as new orders have increased. Construction contracts for commercial and industrial structures have increased sharply in recent months.

Demand for steel has continued to increase, and industry forecasters have raised their estimates for output and shipments this year. Inventory liquidation by steel users appears to have been completed. These inventories apparently will not decline in the first quarter as had been expected a few months ago. Chicago area steel producers are operating at virtual capacity, and at least one firm is confident this will continue through June.

Unemployment compensation claims in the first three weeks of March were below last year in all District States. A few examples will spotlight the intense demand for workers. A steel firm hired a record number of new workers in January, but ended the month with a larger number of unfilled jobs. A utility that made a "generous" labor settlement after a long strike last year finds that compensation now offered workers under the new contract is insufficient to attract enough recruits. "Dirty jobs" are hard to fill in all firms. Reports indicate that shortages of skilled factory, office, and construction workers are the worst since World War II. Apprenticeship and other training programs do not appear to be remedying the deficit in trained workers.

In the auto industry, negotiations are taking place to establish procedures for retaining recently hired workers while laying off some of the experienced workers with considerable seniority. Since the total of State unemployment benefits and union supplements for experienced workers would nearly equal take-home pay, the privileges attached to seniority now cause some workers to seek layoff in preference to job security. This presents problems of retaining adequate experienced and skilled workers under some conditions.

Recent interest rate movements--with short-term rates below long-term rates for the first time since last spring--appear to reflect a growing public sentiment that business activity will continue to rise and that interest rates may increase further.

District banks have continued to expand loans in the past month, with business loans especially strong and metals manufacturers absorbing the lion's share. Bank reports are now showing evidence of some slowing in real estate lending, as well as cutbacks in funds supplied to finance companies. On balance, however, there was little further liquidation of investments during March.

Chicago banks, of course, normally buy Governments in the weeks prior to April 1, in anticipation of customer shifts out of deposits on the personal property tax assessment date. The basic deficit position of these banks has reached record depth in the past two weeks, covered mainly by heavy purchases of Federal funds. Latest information suggests that they expect to get about the usual offsetting inflow of inter-bank funds despite the generally tight money market situation, but some increased demand for discount window accommodation may develop in this connection. So far, reports from our large banks show no evidence of the sale of loans under repurchase agreements, although some are exploring the possibilities.

On the whole, the weekly reporting banks still have about $1 billion more Governments than at the peak of the 1966 squeeze and $1.5 billion more municipals. In view of high loan-deposit ratios and current prices in the securities markets, however, sale of these holdings would be quite distasteful.

Mr. Scanlon then said that he believed the slowing in the growth of aggregate measures of money and credit in the first quarter had been quite appropriate. He recognized that those changes would have their major influence on economic developments in subsequent months, and therefore thought the Committee should take a hard look at the staff's GNP projections against which it had to formulate policy today. The Committee tended to fall into the trap of accepting the staff projections as the goal of policy, although the staff had never represented the figures that way. It seemed to him that the staff's recent revisions made the projections too high to be acceptable as economic goals. Additionally, there was the possibility that the upward revisions were too conservative. In his judgment the Committee's goal should be to attain smaller quarterly increases in GNP than now appeared to be in prospect.

As to the monetary policy most likely to be consistent with that objective, it seemed to Mr. Scanlon that the Committee should try to achieve a slow rate of growth in total reserves. Combined with the first-quarter changes, such a policy should be conducive to a significant slowing in economic activity in the second half without incurring a significant risk of a downturn in economic activity.

Mr. Scanlon indicated that while he favored elimination of Regulation Q in principle, he would not favor an increase in ceiling rates at this time--except possibly some increase along lines suggested by Mr. Mitchell in maximum rates on CD's of $1 million and larger, if that became necessary in order to achieve a moderate growth of bank credit. If Regulation Q were to be generally relaxed now, the Committee should abandon money market conditions as a proximate policy guide and embrace aggregate measures as its immediate policy targets. The increasing ability of banks to develop means for circumventing Q reinforced the desirability of reducing the System's dependence upon that type of control at the earliest opportunity.

While he had favored giving consideration to a change in reserve requirements several months ago, Mr. Scanlon said, he would not advocate such a change now, since he was worried about problems of timing in using that blunt policy instrument. However, he would favor having the matter reconsidered if and when Regulation Q ceilings were changed. He had no strong feeling regarding the establishment of reserve requirements against Euro-dollars except to question whether that device would be totally effective. He had been impressed by the ingenuity of people engaged in the Euro-dollar market who had already worked out various methods of escaping the constraints of a possible imposition of reserve requirements--including the use of brokers and repurchase agreements on Euro-dollars.

Mr. Scanlon added that the directors of the Federal Reserve Bank of Chicago had voted to increase the discount rate to 6-1/4 per cent over his recommendation for an increase to 6 per cent. He had been somewhat surprised by the strong feelings expressed by a majority of the directors, who felt that an increase of 1/2 percentage point in the rate had already been discounted. They believed that if the System was trying to convey its determination to follow a policy of monetary restraint, an increase of 3/4 of a percentage point was desirable, particularly since the current rate was so far out of line with market rates. They agreed, however, that a 1/2 percentage point increase would be acceptable if the Board did not see fit to approve the 6-1/4 per cent rate.

Mr. Scanlon said he favored alternative B of the draft directives.

Mr. Galusha submitted for the record the following comments on developments in the Ninth District:

> The CD trend of recent months was interrupted, at least briefly, in the last week of March. Among our largest banks, the CD attrition was the same for the first three weeks of March as for all of February. But for the last week of March there was a slight net increase in outstanding CD's.
>
> The inflow of funds to District savings and loan associations was slightly smaller in February than in January, but by historical standards still rather considerable. What is most remarkable, our S&L's increased mortgage commitments 13 per cent in February. There apparently was no widespread fear that, come the March 31-April 15 period, there would be a significant outflow of funds. I should add that S&L's have, rightly or wrongly, been encouraged in their optimism by regional Federal Home Loan Bank pronouncements.

With respect to Committee policy, Mr. Galusha commented he did not mind when the System was criticized for not paying enough attention to the money supply. He did get decidedly nervous, however, when the System was criticized for changing policy abruptly, as on several occasions it had. He was therefore relieved when he read in the blue book that if the System kept policy unchanged the rate of growth of the credit proxy would be likely to increase--and to a value which was, he believed, roughly appropriate for the longer-run.

As all Committee members were aware, Mr. Galusha continued, it could be difficult to change from a negative to a positive growth rate in the credit proxy. The business and financial communities might conclude that the System had lost its resolve. Partly to forestall a leap to an erroneous conclusion, he thought the System should increase discount rates to 6 per cent. Ideally, perhaps, the increase should be timed to offset the contemplated sag in bill rates after April 15, but he had developed a certain skepticism over the last eight months in the System's ability to read the future with such precision. He was not sure one week or two would alter expectations very much and in any event the Committee could use open market operations to counter a sharp slide in rates. According to the blue book, with such an increase in discount rates the expected annual rate of increase in the adjusted proxy in April would be 1 or 2 per cent instead of around 4 per cent. But going from a 2 per cent rate of decline in the first quarter to a small increase was a significant move.

However, Mr. Galusha said, at this point he would urge that increases not be made in reserve requirements and ceiling rates on large-denomination CD's, even though it might be argued that the former was desirable mostly for psychological reasons. He simply did not believe the impact could be so delineated. If actions were taken on all three policy instruments--discount rates, reserve requirements, and Q ceilings for large CD's--the April growth rate for the adjusted credit proxy might be around 2 per cent--about the same rate of expansion as that projected on the assumption that action would be limited to an increase in the discount rate to 6 per cent. However, there would seem to be serious risks in making all those changes. Municipal borrowers could be significantly affected. Thrift institutions and builders could be also. And the System might find that it had to increase other Regulation Q ceilings--or that it wanted to, but failing to get interagency agreement, was unable to do so. That would be very serious.

Mr. Galusha added that he was not quite sure that the economic outlook justified additional increases in long-term interest rates. In his own mind, the outlook was perhaps a little less bullish than the staff was currently projecting. The System was producing major restraint. To push the whole spectrum of interest rates higher would not significantly enhance the System's progress toward its announced goals, and it certainly would affect not only the U.S. economy but world financial markets. On a recent foreign trip he had encountered, in Australian and Indian business and banking circles, the same unhappiness as that reported today by Messrs. Brill and Coombs.

In sum, Mr. Galusha said, at this time he favored just increasing the discount rate, but to 6 per cent. That meant, he supposed, that he was also for alternative B of the staff directives.

Before concluding, Mr. Galusha said he wanted to add a few words about Treasury debt management. If he had understood correctly, the Treasury intended to reduce the supply of bills by a sizable amount over the current quarter. It seemed to him, though, that the Treasury should instead either increase its cash balance or, if possible, reduce the supply of notes and bonds. If it were to maintain the present supply of bills, or even increase it, the System would not be faced with a problem of maintaining bill rates near CD ceilings. At any rate, the magnitude of the problem would be reduced.

Mr. Swan reported that there had been no significant new economic developments in the Twelfth District since the previous meeting. He would note only that--in line with Mr. Holmes' comment about the substantial availability of short-term funds from nonbank investors--major District banks were continuing to borrow sizable amounts of funds under repurchase agreements with corporations and public bodies, and some banks had indicated that they were receiving such funds without any particular effort on their part to solicit them.

Turning to policy considerations, Mr. Swan said he found himself in substantial agreement with Mr. Brill. He (Mr. Swan) thought the recent behavior of the monetary aggregates had been satisfactory, but he believed that a discount rate increase of 1/2 percentage point was needed. The current rate was well out of line with market rates and an increase was so widely expected that a failure to act would widen the so-called credibility gap. He would favor an increase in the discount rate regardless of whether it was decided that prospective growth in the monetary aggregates was too rapid or too slow.

Mr. Swan remarked that he agreed with Mr. Scanlon's observation that staff projections should not necessarily be taken by the Committee as goals. However, he would be quite satisfied if the adjusted proxy series behaved in April as the staff projected it would on the assumption of an increase in the discount rate to 6 per cent--namely, showing little change or perhaps increasing slightly. Such behavior, following the decline in the first quarter, seemed more appropriate to him than the increase at a 2 to 6 per cent rate projected on the assumption of no policy action, although he was not persuaded that a discount rate increase alone would have so great an effect on bank credit. In any event, he did not think it was necessary to add further to restraint on the monetary aggregates.

Mr. Swan indicated that he would not favor an increase in Regulation Q ceilings at this time. Nor would he be inclined, on balance, to raise reserve requirements, although he had arrived at that conclusion a little more reluctantly than he had at his conclusion that the discount rate should be increased. His hesitation on the matter partly reflected the fact that Treasury financing activity was not an inhibiting factor at the moment but might be at a later date if it were decided at that time that an increase in reserve requirements was necessary.

Mr. Swan said he favored alternative B for the directive. However, he thought the opening sentence of the staff's draft was not wholly clear, and would prefer to substitute the following two sentences: "The information reviewed at this meeting suggests that expansion in real economic activity has moderated somewhat further but not so much as earlier projections had indicated. Prospects are that further slowing in economic expansion in the period ahead also will be less than expected earlier." For the second paragraph he preferred the language of the staff's draft to the revision Mr. Daane had proposed.

Mr. Coldwell said that recent economic and financial developments in the Eleventh District indicated little over-all change from the trends he had reported earlier. As he saw the national economy developing, it appeared to be still climbing, with strong support from capital spending, construction, and personal consumption. In fact, the only dampening in activity appeared to be in the Government area, where spending was not actually declining but holding at a high level. Wages and prices were still moving up rapidly and, in fact, he detected some acceleration toward higher wage settlements although perhaps a little more management resistance was evident than a year ago. More importantly, he could see possibilities of a new expansion in consumer spending which, along with the capital goods boom, could easily offset any downward tendencies in Government spending.

Mr. Coldwell indicated that he had spent the past week in a conference of corporation presidents listening to their problems and complaints about the economy, and he thought he could summarize their position by saying they were mostly concerned with labor costs and the imperative need for labor-saving capital expansion. High interest rates were a nuisance but not a deterrent. A brief opinion poll of those 60 presidents revealed a strong credibility gap; the majority still believed the Federal Reserve and the Administration would not maintain a restrictive stance, and that inflation in the 5 to 6 per cent range was the most advisable fundamental assumption for business decisions. Thus, it seemed to him that the System was again faced with a need to demonstrate overtly that it was continuing to place pressure on the supply of credit, but to do so in a way that would not cause such a marked upset that intervention would be required to correct a disorderly market.

On the financial side, Mr. Coldwell continued, there had been higher levels of new borrowed reserves and borrowings over the past few weeks, and also technical downward pressure on bill rates, but on many days further increases in long-term yields. The rate of decline in the credit proxy had been at the bottom end of the range expected at the last meeting. On the other hand, Treasury bill rates were also at the low end of the range expected.

Mr. Coldwell indicated that he had been on the morning conference call this past month and had not detected any special strains developing in the markets; in fact, there had been an over-all appearance of business as usual. However, a large number of innovations were being created by bankers to escape the restrictive pressures of Regulation Q ceilings. He was especially concerned about those that permitted banks to issue commercial paper through holding companies--which in turn purchased loans from the bank subsidiaries--and the Board's ruling which permits an affiliate of a bank to bid for public funds at rates above Q ceilings. Perhaps the over-all conclusion from those developments was that there still were large amounts of liquid funds which could be tapped to raise the credit being made available to borrowers.

Turning to policy, Mr. Coldwell recalled that several months ago he had been in favor of an increase in reserve requirements. He still was in favor of a small action tailored largely to the volatile and growing time-deposit area rather than to demand deposits, and, similarly, aimed more at the smaller than at the larger banks. In addition, for more than six weeks the Dallas Bank had been proposing a modest increase in the discount rate, and he continued to believe that such an increase would be desirable. But both of those policy moves were actions which the Board of Governors had to initiate or approve. If there were to be action in either of those two areas he might wish to recommend an open market policy position which would be adaptable to the results of those actions. However, in view of the lack of action over the past several weeks, he had to register his vote for the only policy action on which he could vote today--namely, a more restrictive monetary policy position through open market operations. Thus, he would favor alternative B for the directive. He would, in fact, strengthen the associated specifications to call for an increase in the level of net borrowed reserves to an average of more than $1 billion per week and for a corresponding increase in borrowings.

Mr. Coldwell noted that there was always a possibility that no other policy action would be taken. In that event, under the procedure suggested in the staff notes attached to the draft directives, alternative B would become in effect alternative A. Thus, he believed alternative B should be clarified and strengthened by rewording in the manner Mr. Daane had suggested.

As a side note, Mr. Coldwell continued, he understood that certain Reserve Banks had now adopted a more restrictive administrative posture with regard to the discount window. It had always been the Dallas Reserve Bank's position that administration of the window would remain steady and even-handed, whatever the stance of monetary policy. He had to admit, however, that discount window administration could be and had been used as a device to put greater pressure on the banking system, and unless the System took action in other areas he might reconsider his position.

Implicitly, Mr. Coldwell said, most of the Committee members had approved the gradualist approach toward more restrictive fiscal and monetary policies. However, he thought the evidence to date tended to support the position that that approach just gave market participants and active members of the economy time to out-guess policy and adapt to the actions taken, with the result that inflationary pressures in the economy were perpetuated and perhaps even strengthened. For his part, he was unwilling to wait longer. He was unhappy that the System's policy had not had greater effect in the real economy and he believed the System had to act now, even risking some of the adverse effects that might not have been present with earlier action.

Mr. Coldwell said he did not favor a change in the Regulation Q ceilings at this time.

Mr. Morris said he thought the policy assumption underlying the staff's present GNP projections for 1969--that bank credit would expand at a 5 per cent rate--was quite arbitrary. He thought the GNP projections would be much more useful to the Committee if they were based on the assumption of a continuation of the existing degree of monetary restraint. On that basis, the members would have a better appreciation of the implications of a policy change in either direction.

Mr. Morris then commented that the present was a rather frustrating point in time for monetary policy-makers. A very restrictive policy had been in force for three and one-half months and no signs of any significant impact of that policy were yet to be seen in the current business statistics. The February business figures, which continued to be dominated by excessive strength in business fixed investment, remained disturbingly strong.

Relatively little headway had been made in curbing inflationary expectations, Mr. Morris continued. Bankers were getting the word, but the System's actions still had not had a major impact on the thinking of the business community or the investing public. Inquiries made in the Boston area suggested that, thus far, the impact of the Committee's actions on expectations had been diluted in part by the stream of statements coming out of the new Administration indicating their intention to deal with inflation without increasing unemployment. Since the market did not believe that could be accomplished, the statements had tended to create a credibility gap concerning the real resolve of both the Administration and the Federal Reserve to fight the inflation.

In that context, Mr. Morris remarked, it was natural that there should be an urge to get faster results by adopting a still more restrictive monetary policy. That was an urge which he thought should be resisted. He believed that the current policy was having the desired impact on the financial system and that the effects of monetary restraint would be showing through in economic activity and business expectations during the next few months. To attempt to shorten the process by a still more restrictive policy would run the clear risk of an over-reaction and disorderly markets.

Mr. Morris said that three developments in the First District during the past week suggested to him that the current policy was beginning to bite. First, one large Connecticut bank was selling $27 million of municipal bonds to finance loans for which commitments had been made earlier; that was a rather painful step for the bank and it had changed its loan commitment policies. Second, another large Connecticut bank, which had been diligently cultivating the construction loan business as the most profitable outlet for its funds, had reluctantly decided not to make any additional commitments for construction loans. It appeared that in New England the initial constraint of monetary policy on housing might come from a shortage of construction loan money rather than a shortage of mortgage money. Third, one of the large Boston banks was refusing to make term loans to large established customers for the purpose of financing plant expansion.

Mr. Morris indicated that the Boston Reserve Bank was one of those which had not submitted a request for an increase in the discount rate. The directors of the Boston Bank did not believe that an increase to 6 per cent would have a significant impact on expectations. On the other hand, they believed that such an increase would inevitably lead to greater pressure to raise Regulation Q ceilings, an action which they thought would tend to undermine policy. As Mr. Holmes had pointed out, the market was likely to interpret an increase in Regulation Q ceilings as a move to ease policy and one which would reduce the pressures on the larger banks. Mr. Morris added that the directors of the Boston Bank would be prepared to raise the discount rate to 6 per cent later in April, if such an action appeared to be needed then to keep the three-month bill rate from declining below 5-3/4 per cent. In other words, the directors would be quite willing to raise the rate to 6 per cent if such an action was needed to make the current monetary policy viable, but not if the increase were meant to signal a more restrictive policy.

Mr. Morris noted that one of the directors of the Boston Bank had suggested that it might be advisable to raise the reserve requirements of country banks in order to even out the impact of current monetary restraint on the banking system as a whole. Research done at the Boston Bank on that issue produced the surprising result that the banks under the most pressure during the past three months had not been the reserve city banks but the large country banks--that is, country banks with deposits of $100 million or more. Those banks had suffered greater losses in both demand and time deposits than the reserve city banks and they had not been able to offset those losses through the Euro-dollar market. Needless to add, he (Mr. Morris) was not promoting the director's suggestion since it was based on a false preconception--that he had shared--regarding the incidence of monetary restraint.

Mr. Morris observed that monetary policy was very restrictive at present; too restrictive, he believed, to be sustained for any extended period. In his judgment it would be unwise to seek a still more restrictive policy package primarily for the announcement effects it might have.

Mr. Morris added that in his opinion a policy change that would have a very constructive announcement effect would be the suspension of the investment tax credit. He was fully aware of the political and administrative problems such a suspension would cause, but he thought it simply did not make economic sense for the Federal Government to be subsidizing plant and equipment investment in the economic circumstance of 1969. More important, suspension of the tax credit would permit the System to adopt a less restrictive policy than otherwise.

In summary, Mr. Morris noted that he would not advocate an increase in the discount rate to 6 per cent unless such an action was needed after mid-April to bolster Treasury bill rates. His primary concern was that a discount rate change would lead to increased pressure to raise Regulation Q ceilings, which in turn could mean a quite dramatic restructuring of the posture of policy and could have an unfortunate impact on market psychology.

It was true that an increase in the Q ceilings would tend to ease pressures in the Euro-dollar market. However, he thought it was not unreasonable to expect European countries to adapt to U.S. interest rate developments, just as in the early 1960's the United States had had to adapt to higher interest rates in Europe. He would not favor an increase in reserve requirements that was designed as a move toward more monetary restraint. He would favor a reserve requirement action that was designed to spread the impact of monetary policy more evenly, but in light of the research he had cited earlier he doubted that such an action would be feasible.

In general, Mr. Morris said, he was satisfied that under the current posture of policy the needed results would be achieved. Accordingly, he favored alternative A of the draft directives.

Mr. Robertson made the following statement:

> I would like to start off by commenting about a matter which is not listed on our agenda for today. The Committee members have now all received the final report of the Government securities market study, and I suppose we will be considering it at our next meeting. I recognize that it does not formally recommend any further changes in open market policies or operations at this juncture. Nevertheless, I think the Committee should not let pass this opportunity to consider very carefully what it ought to do in the way of outright operations in Federal agency securities.
>
> From time to time in the past, I have pointed out in my comments here what I regard as compelling reasons for our authorizing the Manager to begin some small and experimental operations in agencies. Nothing that I read in the report makes me think that we should hold

off any longer. I won't take time to argue the case today, but I do intend to do so when the report comes up on the agenda next time. Between now and then, I would hope that each member could give this question some further serious attention.

Turning to monetary policy, I think it is obvious that we have a difficult task cut out for us. Even though we have taken some actions, we still have not made enough headway in the battle against inflation. Most interest rates are higher than at the beginning of the year and the growth of monetary aggregates has slowed, but these developments have not generated much of a shift to appropriately anti-inflationary policies throughout the financial system, and they have scarcely touched the powerful spending intentions of the business community. The blunt fact of the matter is that nothing that we have said or done to date, and nothing that Government policy-makers generally have said or done up to now, has been enough to dampen private inflationary attitudes or the deep-rooted public skepticism as to the ability and determination of fiscal and monetary authorities to do what they say they will do.

In these circumstances, I think it behooves the System to run somewhat bigger risks of becoming too tight in the interest of curbing these pernicious inflationary expectations. I hope that our fiscal authorities will follow a parallel course, and produce enough deeds of budgetary restraint to validate their professed intentions. But we have learned from bitter experience how unwise it is to hold off monetary actions in the hope that promised fiscal measures will do the trick. I think the time for us to act is now, in the days and weeks immediately ahead. To wait much longer would allow the expected second-quarter easing of short rates to erode such credit restraint as we have managed to obtain.

Deciding precisely what to do is every bit as difficult as deciding to do something. We need to guard against using any one of our policy tools--however conventional or conveniently at hand--to do something for which it is less well suited than another of our instruments.

To my mind, this argues against a simple increase in discount rates or Regulation Q ceilings, alone or in combination with one another. The all too likely consequence of such action would be to raise interest rates another notch, without any restraint on availability. Indeed, a Q ceiling increase could well let more funds flow through the banks, thus creating a more accommodative atmosphere. The one clear-cut and unequivocal action on availability at our disposal is an increase in member bank reserve requirements. By such a step, every subject bank will be compelled in effect to freeze some of its liquid resources, with a corresponding shrinkage in its available loanable funds. That is exactly what we want to achieve.

That kind of reserve action, in conjunction with present market circumstances, might make a discount rate increase an appropriate accompanying or following action, but in my view that rate should be cast in a subordinate role.

Similarly, I think open market operations are best cast in a supportive role at this juncture. Between now and the time any other policy action is announced, I would favor having the Manager hold a very firm rein on money market and reserve conditions. Following publication of any other action, I would encourage him to allow their announcement and availability effects to exert some upward market pressures, and to cushion them only if reactions seem to be carrying clearly beyond the upper limits described in the blue book.

Finally, there are no consequences within the situation as I see it that would lead me to favor an increase in Q ceilings.

With these views in mind, I would be prepared to vote for alternative B for the current economic directive.

Mr. Robertson added that he considered the first sentence Mr. Swan had proposed for the directive to be a better statement of the thought he assumed had been intended in the staff's draft. However, he would be inclined to omit the second of the two sentences Mr. Swan had proposed.

In his judgment, Mr. Robertson said, many of the devices banks were using to obtain funds--either directly or through repurchase agreements entered into by bank holding companies--violated at least the spirit of the law. The use of such devices was likely to spread with extraordinary speed, and he did not believe that the System could stand by and permit that to happen. The System also would have to keep an eye on the Euro-dollar situation. The present was not necessarily the best time for action in that area, but the System could not afford to have the effectiveness of monetary policy undercut by bank access to the Euro-dollar market.

Mr. Swan commented that he had suggested the second of the two sentences to which Mr. Robertson had referred simply to retain the reference made in the staff draft to prospective activity. He was agreeable to the proposal that it be omitted.

Mr. Daane noted that there was no reference to inflationary expectations in the staff draft. He thought it would be desirable to indicate, in connection with the statement on prices and costs, that such expectations were pervasive.

Chairman Martin said he did not think a group as large as the Committee could act effectively as a drafting body. His inclination would be to accept the draft directive as written if the members thought it was generally satisfactory.

The Chairman then said that he had found the discussion at today's meeting to be one of the most interesting in some time. It was clear that individual members approached the problems facing the System from different perspectives. In his judgment the primary problem at the moment was that of the prevailing inflationary psychology. The present inflationary situation seemed to him to be the most serious of any in recent years; there were many signs indicating that inflation was becoming a way of life in the nation today.

Chairman Martin remarked that policy makers had to come to grips with the problem--the System in the monetary policy area and the Administration in the area of fiscal policy. He thought the Board would have to make decisions very soon on the policy instruments for which it was responsible. It was quite helpful to have had the views of the Reserve Banks Presidents in that connection.

The Chairman then observed that he agreed with the majority sentiment in favor of alternative B of the draft directives. He suggested that the Committee vote on that alternative in the form submitted by the staff.

Mr. Daane asked whether the Manager would feel obliged under alternative B to take action to maintain the status quo in money and short-term credit markets if conditions were tending to firm as a result of policy actions taken by the Board.

Mr. Holmes said he thought it was quite clear from the discussion today that the Committee would not want him to offset such a tendency toward firmer conditions.

Mr. Daane then said that on that basis he could vote for B.

Mr. Coldwell asked how alternative B would be interpreted if the Board did not take any firming action. He inferred from the blue book and the notes attached to the draft directive that in such an event alternative B would be interpreted as if it were A.

Chairman Martin commented that he personally would not favor such a course. He added that it was important for the Committee to consider the blue and green books only as guides to policy formation. Otherwise, future historians were likely to conclude that the Committee had suffered from what might be called "statisticitis."

Mr. Robertson remarked that from the discussion he would assume that the members expected firming action to be taken by the Board, but that if such action were not taken they would want the Manager to seek firmer conditions through open market operations.

Mr. Mitchell said he did not share that view. In his judgment, the purpose of any action the Board might take would be to affect the prevailing psychology; he did not think action would be wanted for the sake of slowing further the growth in the monetary aggregates. However, the question Mr. Coldwell had raised struck him as largely academic, since he expected that the Board would take firming action.

Mr. Coldwell said he would find it necessary to dissent from the directive because if there were no action by the Board he could see no further restraint, and he considered further restraint to be an imperative in the present situation.

Mr. Maisel said he planned to dissent from the directive because he believed that attempts to influence psychology and spending directly by Federal Reserve action were incorrect policy objectives. He also did not believe that the Committee should change open market operations until it found that its current settings of the money market variables were leading to a flow in the monetary aggregates above levels that it considered as proper. The Committee certainly should not raise the level of market rates and increase market firmness at a time when the projected flows in the monetary aggregates were below the minimum rate of monetary growth that seemed desirable and maintainable for a considerable period.

With Messrs. Coldwell and Maisel dissenting, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following current economic policy directive:

The information reviewed at this meeting suggest that, while expansion in real economic activity has moderated somewhat further, current and prospective activity now appears stronger than earlier projections had indicated. Substantial upward pressures on prices and costs are persisting. Most long-term interest rates have risen further on balance in recent weeks, but movements in short-term rates have been mixed. In the first quarter of the year bank credit changed little on average, as investments contracted while loans expanded further. In March the outstanding volume of large-denomination CD's continued to decline sharply; inflows of other time and savings deposits were moderate; and growth in the money supply remained at a sharply reduced rate. It appears that a sizable deficit reemerged in the U.S. balance of payments on the liquidity basis in the first quarter but that the balance on the official settlements basis remained in surplus as a result of further large inflows of Euro-dollars. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the reduction of inflationary pressures, with a view to encouraging a more sustainable rate of economic growth and attaining reasonable equilibrium in the country's balance of payments.

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

Chairman Martin then noted that in a memorandum[1/] dated March 17, 1969, the Secretariat had raised the possibility of rescheduling for June 24 the Committee meeting that was listed for June 17 in the tentative 1969 schedule. The purpose would be to

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

avoid a conflict with the 1969 Monetary Conference of the American Bankers Association, which would be held in Copenhagen June 15-20, and which several members of the Committee were planning to attend.

The Chairman asked whether there would be any objections to such a change in the tentative schedule, and none was heard.

It was agreed that the next meeting of the Committee would be held on Tuesday, April 29, 1969, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

March 29, 1969

Drafts of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on April 1, 1969

FIRST PARAGRAPH

The information reviewed at this meeting suggests that, while expansion in real economic activity has moderated somewhat further, current and prospective activity now appears stronger than earlier projections had indicated. Substantial upward pressures on prices and costs are persisting. Most long-term interest rates have risen further on balance in recent weeks, but movements in short-term rates have been mixed. In the first quarter of the year bank credit changed little on average, as investments contracted while loans expanded further. In March the outstanding volume of large-denomination CD's continued to decline sharply; inflows of other time and savings deposits were moderate; and growth in the money supply remained at a sharply reduced rate. It appears that a sizable deficit reemerged in the U.S. balance of payments on the liquidity basis in the first quarter but that the balance on the official settlements basis remained in surplus as a result of further large inflows of Euro-dollars. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the reduction of inflationary pressures, with a view to encouraging a more sustainable rate of economic growth and attaining reasonable equilibrium in the country's balance of payments.

SECOND PARAGRAPH

Alternative A

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

Alternative B

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

ATTACHMENT B - 1

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 4, 1969

To Mr. Holland

From J. Charles Partee

Subject: Correction of Data Presented to FOMC on Business Capital Spending Plans.

In my presentation to the Federal Open Market Committee on April 1, I indicated that preliminary and confidential tabulations from the Commerce-SEC plant and equipment spending survey showed that the very large manufacturing firms were planning only a 7 per cent increase in outlays this year, while medium-size firms (total assets from $10 to $100 million) had reported plans for a 28 per cent increase. Final tabulations have just been received from Commerce on this point, and they now show a 12.9 per cent increase in planned outlays for the largest firms. Medium size manufacturers are still shown as planning a much larger rise--28.8 per cent--but the increase for the large companies is so much greater than I reported that I believe the correction should be brought to the attention of the Committee.

A table showing the results of the final tabulation, for the confidential use of Committee members and staff, is attached.

JCP

Attachment.

Plant and Equipment Expenditures for Manufacturing, by Size of Firm 1968-1969
Per cent change 1/

Sector and Size of firm (total assets in mils. of dollars)	Not Seasonally Adjusted			Annual change 1968-1969	Seasonally Adjusted		
	1st Half '68 to 2nd Half '68	2nd Half '68 to 1st Half '69	1st Half '69 to 2nd Half '69		1st Half '68 to 2nd Half '68	2nd Half '68 to 1st Half '69	1st Half '69 to 2nd Half '69
Total manufacturing	15.1	-1.2	19.6	16.2	2.6	10.7	6.7
under 10	4.6	.8	6.0	6.1	-6.9	13.1	-5.6
10 - 99	17.7	4.2	28.6	28.8	4.9	16.7	14.8
100 and over	18.0	-4.8	19.2	12.9	5.2	6.5	6.5
Durable	18.5	-3.5	19.6	14.9	4.1	9.8	4.9
under 10	5.1	-2.2	2.5	1.5	-7.6	11.3	-10.0
10 - 99	23.6	3.2	28.5	30.3	8.6	17.4	12.8
100 and over	21.9	-8.1	21.3	11.7	7.2	4.6	6.4
Nondurable	11.8	1.4	19.6	17.5	1.1	11.7	8.6
under 10	3.8	4.9	10.5	12.4	-6.0	15.6	0.3
10 - 99	11.8	5.3	28.8	27.2	1.1	16.0	17.0
100 and over	14.3	-1.6	17.4	14.0	3.5	8.4	6.6

1/ Not for publication.

ATTACHMENT B - 2