MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, March 10, 1970, at 9:30 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Brimmer
Mr. Daane
Mr. Heflin
Mr. Hickman
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Sherrill
Mr. Swan
Mr. Kimbrel, Alternate for Mr. Francis

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

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

Mr. Holland, Secretary
Mr. Broida, Deputy Secretary
Messrs. Kenyon and Molony, Assistant Secretaries
Mr. Hackley, General Counsel
Mr. Partee, Economist
Messrs. Axilrod, Craven, Garvy, Hocter, Jones, Parthemos, and Solomon, Associate Economists
Mr. Holmes, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Bernard, Assistant Secretary, 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. Keir, Associate Adviser, Division of Research and Statistics, Board of Governors
Mr. Wendel, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Ormsby, Special Assistant, Office of the Secretary, Board of Governors
Miss Eaton, Open Market Secretariat Assistant, Office of the Secretary, Board of Governors

Mr. Lewis, First Vice President, Federal Reserve Bank of St. Louis
Messrs. Baughman and Tow, Senior Vice Presidents of the Federal Reserve Banks of Chicago and Kansas City, respectively
Messrs. Brandt and Green, Vice Presidents of the Federal Reserve Banks of Atlanta and Dallas, respectively
Messrs. Gustus and Kareken, Economic Advisers of the Federal Reserve Banks of Philadelphia and Minneapolis, respectively
Mr. Friedman, Consultant, Federal Reserve Bank of Boston
Mr. Sandberg, Securities Trading Officer, Federal Reserve Bank of New York

The Secretary reported that advices had been received of the election by the Federal Reserve Banks of members and alternate members of the Federal Open Market Committee for the term of one year beginning March 1, 1970, that it appeared that such persons were legally qualified to serve, and that they had executed their oaths of office.

The elected members and alternates were as follows:

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

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

Aubrey N. Heflin, President of the Federal Reserve Bank of Richmond, with Frank E. Morris, President of the Federal Reserve Bank of Boston, as alternate;

Darryl R. Francis, President of the Federal Reserve Bank of St. Louis, with Monroe Kimbrel, President of the Federal Reserve Bank of Atlanta, as alternate;

Eliot J. Swan, President of the Federal Reserve Bank of San Francisco, with Hugh D. Galusha, Jr., President of the Federal Reserve Bank of Minneapolis, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until the election of their successors at the first meeting of the Committee after February 28, 1971, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, as the case might be, they would cease to have any official connection with the Federal Open Market Committee:

Arthur F. Burns	Chairman
Alfred Hayes	Vice Chairman
Robert C. Holland	Secretary
Arthur L. Broida	Deputy Secretary
Kenneth A. Kenyon and Charles Molony	Assistant Secretaries
Howard H. Hackley	General Counsel
David B. Hexter	Assistant General Counsel
J. Charles Partee	Economist
Stephen H. Axilrod, J. Howard Craven, George Garvy, Lyle E. Gramley, A. B. Hersey, William J. Hocter, Homer Jones, James Parthemos, John E. Reynolds, and Robert Solomon	Associate Economists

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

Open Market Account until the adjournment of the first meeting of the Federal Open Market Committee after February 28, 1971.

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

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

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on February 10, 1970, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee held on February 10, 1970, was accepted.

Consideration was then given to the continuing authorizations of the Committee, according to the customary practice of reviewing such matters at the first meeting in March of every year. It was observed that by note incorporated in the agenda the Secretariat had proposed that actions by the Committee with respect to certain of these matters be taken on the understanding that each of the actions would remain effective until otherwise directed by the Committee, so that they would no longer be subject to regular annual review. The matters for which the Secretariat had made this proposal were (a) the procedure for allocations of securities in the System Open Market Account; (b) the distribution list for periodic reports prepared by the Federal Reserve Bank of New York; (c) the authority for the Chairman to appoint a Federal Reserve Bank as agent to operate the System Account in case the New York Bank was unable to function; (d) and (e) resolutions providing for continued operation of the Committee, and for certain actions by the Reserve Banks, during an emergency; (f) a resolution relating to examinations of the System Open Market Account; and (g) the procedure for granting access to records of the Committee.

Mr. Daane commented that while he did not feel strongly about the matter he thought the Committee's traditional practice of subjecting the matters in question to an annual review had served a useful purpose in reminding the members of them. In addition, with respect to one item in the list--the procedure for granting access to the Committee's records--it was his opinion that there were substantive reasons for an annual review.

After discussion, it was suggested by the Chairman that the procedure for granting access to Committee records remain subject to annual review; and that, for the other items listed, the Committee follow the procedure proposed by the Secretariat--but on the understanding that the documents in question would be called to the Committee's attention annually and the members would be given an opportunity to raise any questions they had concerning them.

There was general agreement with the Chairman's suggestion.

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

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

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

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

By unanimous vote, the following list for distribution of periodic reports prepared by the Federal Reserve Bank of New York for the Federal Open Market Committee was approved without change:

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

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* Weekly reports only.

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

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

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

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

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

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

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

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

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

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

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

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

Prior to the Committee's actions on the three preceding items, Mr. Coldwell had indicated that it was not clear to him whether they were intended to relate to domestic open market operations alone or also to foreign currency operations. There had been general agreement with a suggestion by Mr. Robertson that the Committee act affirmatively on the matters at this time on the understanding that Mr. Maisel, to whom the Board had delegated authority to carry out the Board's emergency planning responsibilities, would examine the question raised by Mr. Coldwell and that, if the examination indicated a need for further action, appropriate recommendations would be made to the Committee at an early meeting.

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

Reference was made to the procedure authorized at the meeting of the Committee on March 2, 1955, and most recently reaffirmed on March 4, 1969, whereby, in addition to members and officers of the Committee and Reserve Bank Presidents not currently members of the Committee, minutes and other records could be made available to any other employee of the Board of Governors or of a Federal Reserve Bank with the approval of a member of the Committee or another Reserve Bank President, with notice to the Secretary.

It was stated that lists of currently authorized persons at the Board and at each Federal Reserve Bank (excluding secretaries and records and duplicating personnel) had recently been confirmed by the Secretary of the Committee. The current lists were reported to be in the custody of the Secretary, and it was noted that revisions could be sent to the Secretary at any time.

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

Mr. Brimmer then remarked that it might be desirable to ask the staff to undertake a new examination of the appropriateness of a 90-day lag for the release of the Committee's policy records. There recently had been public criticism--and he had heard some privately--to the effect that 90 days represented an unnecessarily long delay in releasing the records. As the members would recall, that time interval had been selected in preference to the alternative of a 60-day lag shortly before the Public Information Act had become effective in mid-1967. While he would want to guard against an undue reduction in the lag, the experience of the past 2-1/2 years might suggest that it would be appropriate to shorten it to 60 days.

Mr. Hickman commented that in any such examination the staff should give special attention to the problems that would have been posed by a 60-day lag in connection with the records for the first two meetings of 1970, when monetary policy was in process of change.

Mr. Mitchell observed that he had no objections to asking the staff to look into the matter. He would note, however, that if the Open Market Committee was disposed to move in the direction that had been recommended by the Committee on the Directive,[1] the experience of the past might have little relevance to the question of the time-lag that would be appropriate in the future.

Mr. Daane said he would have reservations about shortening the lag to 60 days whether or not the course recommended by the Committee on the Directive was followed. In any event, he hoped the objective would be to determine the appropriate, rather than the shortest possible, time-lag for release of the entries.

The Chairman suggested that the staff be asked to consider the pros and cons of alternative lags and to report to the Committee before the next meeting if at all possible.

There was general agreement with the Chairman's suggestion.

Chairman Burns then noted that on March 4, 1970, there had been distributed a memorandum from the Manager entitled "System

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1/ This Committee, which consisted of Messrs. Maisel, Morris, and Swan, had submitted a report to the Open Market Committee on March 2, 1970. A copy of the report has been placed in the Committee's files.

lending of securities--experience to date and recommendations."[1/] He asked Mr. Holmes to comment.

Mr. Holmes observed that, as the members would recall, when the Committee had amended the continuing authority directive on October 7, 1969, to authorize the lending of Government securities from the System Open Market Account it had been understood that the authorization would be reviewed at intervals of six months. Today's meeting seemed to be an appropriate occasion for the first semi-annual review since the Committee would be reviewing the continuing authority directive in any case.

As noted in his memorandum, Mr. Holmes continued, it was his judgment that System lending of securities remained necessary for the effective conduct of open market operations. Accordingly, he recommended that the authorization be continued subject to periodic review in the future.

Mr. Holmes went on to say that the memorandum also reported certain minor changes that had been made in procedures on the basis of experience. These included extension of the time deadline before which loans had to be initiated by dealers on a particular day and permission for dealers to make substitutions of collateral and partial early repayments

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

where there was good reason for such actions and where Reserve Bank work loads permitted.

More importantly, Mr. Holmes observed, the memorandum discussed certain changes that he recommended the Committee make in its instructions governing loans of securities to dealers. The first of these was to extend the period for which securities might be loaned to dealers from three to five business days. The experience to date had been that most loans were repaid early--usually after one day--but that where longer periods were required five days would often have been preferable to three. He saw no real need for limiting the term to three days, and he would expect that most loans would still be repaid early if five-day terms were authorized.

Secondly, Mr. Holmes continued, he recommended amending the present form of loan contract to introduce the concept of "reasonable certainty" in the dealer's certification that he was borrowing securities to meet a problem posed by a delivery "fail" and that he could not borrow the necessary securities elsewhere in time to fulfill a contractual obligation to sell and deliver such securities today. It had been pointed out that the language of the present contract could be read to require the dealer to be absolutely certain on both counts, and that in many cases it would be possible to arrive at such certainty only when it was too late in the day to borrow the securities. The New York Bank had taken the position that only reasonable certainty was required, since a narrow interpretation of the language of the loan contract would mean that few loans of securities would be made. The proposal, in effect, was to clarify the language of the contract on the matter in question.

The third recommendation, Mr. Holmes observed, was to modify the rates charged on loan contracts not terminated by the maturity date. At present, dealers were charged interest at a rate of 3/4 per cent per annum per day for the first three days of the loan, and a penalty rate--which could be waived by the New York Bank when circumstances warranted--of 6 per cent for subsequent days. It was now proposed to charge 3/4 per cent for the first five days of the loan--assuming the Committee approved the extension of term to five days--and then employ a sliding scale for successive one-day renewals, ranging from 1-1/2 per cent for the first renewal up to 4-1/2 per cent for the third and 6 per cent for any subsequent renewals. The Desk would retain the option of waiving such penalty rates if circumstances warranted.

Finally, Mr. Holmes said, it was proposed to increase the limit on the volume of security loans that might be outstanding to any one dealer at any one time from $75 million to $150 million par value. The larger amounts would be available for loans to dealers whose trading volume and capital position, in the judgment of the Desk, warranted them.

In his opinion, Mr. Holmes commented, all of the changes he had discussed were consistent with the original purpose for which the Committee had authorized lending of securities--namely, that of improving the functioning of the market by reducing the problems associated with delivery failures. The memorandum also proposed an additional change in the instructions, under which the System Account would be authorized to lend securities of the same issue that dealers had placed with the Federal Reserve Bank for de-registration. However, he would now recommend that the Committee postpone consideration of that proposal to allow more time for analysis by Committee Counsel.

Chairman Burns remarked that he understood the Board's staff had carefully reviewed the changes in instructions Mr. Holmes was recommending today and had found no reason to object to them.

Mr. Robertson said he had no objections to those changes nor to the proposal that the authority to lend securities be continued, but he would like to sound a note of caution. As the members would recall, last October the Committee had concurred in Counsel's opinion that lending of securities was authorized under the Federal Reserve Act only on the basis of a finding that operations of that type were reasonably necessary to the effective conduct of open market operations. It was important always to keep that purpose in mind when reviewing the operations and any proposed changes in them. For example, when the Committee considered the proposal relating to lending securities of the same issue as those placed with the Federal Reserve for de-registration, he would want to have the legal basis of any such lending carefully reviewed.

Mr. Daane said he thought the lending operations had been helpful, and he was sympathetic to the changes in instructions recommended today. He then recalled that when the Committee had authorized lending operations in October the Treasury had been actively considering authorizing certain Federal agencies to engage in similar lending operations from their own portfolios should they desire to do so. He asked about the Treasury's present position on the matter.

Mr. Holmes replied that at the moment the question was in abeyance at the Treasury, but in his judgment it was still possible that they would move ahead with the authorization. They were particularly interested in the proposal to lend the same issues as had been submitted for de-registration, since such a procedure would improve the tradeability of registered bonds.

In response to the Chairman's request for comment, Mr. Hackley said it appeared from Mr. Holmes' memorandum that the lending operations in question were still reasonably necessary to the effective conduct of open market operations; therefore, in his judgment, they were legally authorized under the Federal Reserve Act. He saw no legal problems with any of the changes in instructions Mr. Holmes had recommended today. He would, however, need more time to consider the legal implications of the additional proposal made in the memorandum relating to securities placed with the System for de-registration.

Chairman Burns asked whether there were any objections to the changes in instructions that Mr. Holmes had recommended today, and none was heard.

The Chairman then noted that by memorandum[1/] dated March 5, 1970, the Secretariat had recommended an amendment to the continuing authority directive. He asked Mr. Holland to comment.

Mr. Holland observed that the proposed amendment related to the language that had been introduced in paragraph 2 of the continuing authority directive in October 1969 to authorize Reserve Banks other than the New York Bank to purchase special short-term certificates of indebtedness from the Treasury for their own account at times when the New York Bank was closed. Both the Committee's Counsel and the Manager concurred in the proposed change, which was simply for the purpose of clarifying the Committee's intent.

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

By unanimous vote, the continuing authority directive to the Federal Reserve Bank of New York with regard to transactions in U.S. Government securities, bankers' acceptances, and agency issues was amended to read as follows:

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

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

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

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

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

3. In order to insure the effective conduct of open market operations, the Federal Open Market Committee

> authorizes and directs the Federal Reserve Banks to lend U.S. Government securities held in the System Open Market Account to Government securities dealers and to banks participating in Government securities clearing arrangements conducted through a Federal Reserve Bank, under such instructions as the Committee may specify from time to time.

The Committee then turned to consideration of the authorization for System foreign currency operations and the foreign currency directive.

Mr. Coldwell noted that under paragraph 1B(4) of the authorization, the System Account was authorized to hold up to $300 million equivalent of sterling purchased on a covered or guaranteed basis in terms of the dollar under agreement with the Bank of England; and under paragraph 1C(2) the Account was authorized to have outstanding up to $500 million of forward commitments to deliver Italian lire under special arrangements with the Bank of Italy. He asked whether there was any current need to retain those two paragraphs in the authorization.

Mr. Coombs remarked that from time to time he had given some thought to the possibility of recommending that the limit in paragraph 1B(4) be reduced to $200 million, the level that had been in effect before the spring of 1968. As the members would recall, the limit had been increased to $300 million at that time in connection with arrangements that had been worked out to help the Bank of England clear up its drawings on the Federal Reserve swap line.

He had not made such a recommendation partly because of the possibility that the larger limit would prove useful in some future contingency.

Mr. Coldwell expressed the view that the possibility of such contingencies in itself did not warrant keeping particular authorities in place once the original need for them had passed. If a contingency did arise the Special Manager could always recommend appropriate measures for Committee consideration.

Chairman Burns commented that there was much merit in Mr. Coldwell's observation. He proposed that the Committee reaffirm the foreign currency authorization and directive at this time and ask Mr. Coombs to prepare a memorandum for its consideration on the question raised by Mr. Coldwell.

There was general agreement with the Chairman's proposal.

> By unanimous vote, the authorization for System foreign currency operations given below was reaffirmed:

AUTHORIZATION FOR SYSTEM FOREIGN CURRENCY OPERATIONS

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

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

1934, with foreign monetary authorities, and with the Bank for International Settlements:

Austrian schillings
Belgian francs
Canadian dollars
Danish kroner
Pounds sterling
French francs
German marks
Italian lire
Japanese yen
Mexican pesos
Netherlands guilders
Norwegian kroner
Swedish kronor
Swiss francs

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

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

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

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

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

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

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

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

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

D. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

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

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	200
National Bank of Belgium	500
Bank of Canada	1,000
National Bank of Denmark	200
Bank of England	2,000
Bank of France	1,000
German Federal Bank	1,000
Bank of Italy	1,000
Bank of Japan	1,000
Bank of Mexico	130
Netherlands Bank	300
Bank of Norway	200
Bank of Sweden	250

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Swiss National Bank	600
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,000

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

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

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

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

All actions taken by the Subcommittee under this paragraph shall be reported promptly to the Committee.

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

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

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

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

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

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

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

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

FOREIGN CURRENCY DIRECTIVE

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

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

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

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

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

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

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

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

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

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

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

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

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

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period February 10 through March 4, 1970, and a supplemental report covering the period March 5 through 9, 1970. Copies of these reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Coombs said that since the last meeting of the Committee there had been important developments in sterling, the mark, and the lira. Sterling had been extremely strong, with inflows of nearly $900 million in February and almost $600 million so far in March. Balance of payments surpluses, favorable seasonal influences, and a reversal of leads and lags had all contributed to those gains. In recent weeks, however, another factor had come to the fore--the severe tightness of credit in London, with local rates rising appreciably above Euro-dollar levels, had pulled in a lot of hot money which could, of course, flow out again just as fast.

Against that background, Mr. Coombs continued, for purely external reasons the Bank of England had cut its discount rate from 8 to 7-1/2 per cent last Thursday (March 5). He thought that had been a prudent move and most of those at the Basle meeting during the past weekend shared that view. The sterling rate had come down to more natural levels, and although future inflows would probably be smaller they should be more sustainable.

Meanwhile, Mr. Coombs observed, the Bank of England had continued to pay off debt. There would be no need to use the end-of-March backstop facility which the Federal Reserve had agreed to provide against the remaining $200 million of overnight credits from the Treasury. He was hopeful that the British would also be able to pay off at maturity the $250 million credit from the Bank for International Settlements, which had made possible the cleanup of their swap debt to the Federal Reserve and which the System had agreed to backstop. Of the $250 million total, which would mature over the next few months, the British were repaying $50 million today.

Turning to the mark, Mr. Coombs commented that Germany had also been faced with an inflationary problem, with the annual rate of increase in the cost of living rising to nearly 4 per cent in recent months. The German Government had been unsuccessful in an effort to put through additional tax measures. Consequently, it had to fall back upon credit policy; last Friday (March 6) the

German Federal Bank had raised its discount rate from 6 to 7-1/2 per cent and the Lombard rate from 9 to 9-1/2 per cent. The German authorities expected that as a result of those changes in official rates bank lending rates would move up to 11 per cent or so and bond yields to more than 9 per cent. They also believed that those higher rate levels would help considerably to damp down inflationary expectations.

On the other hand, Mr. Coombs continued, the German authorities fully recognized that such rate levels also could pull in a lot of money from the Euro-dollar market. To guard against that risk, the Federal Bank had introduced a reserve requirement of 30 per cent against new foreign deposits. The major loophole was the possibility of borrowing by German industry in the Euro-dollar market, which conceivably could build up gradually over the rest of the year to a fairly large total. At the same time, foreign borrowing in Germany would be constrained. Accordingly, there might be renewed growth in German reserves with possible pressures on other markets. On the other hand, the effects of the mark revaluation on the German trade balance were beginning to become evident. It was too early to say whether that would offset the forces tending to increase German reserves.

One useful feature of the German rate increase, Mr. Coombs observed, was that it provided a golden opportunity for the Bank of Italy to follow suit. For the past few months Italian interest rates had been appreciably below Euro-dollar levels, thereby aggravating capital outflows and contributing to reserve losses totaling more than $1 billion since the beginning of the year. To help finance those losses, the Bank of Italy had drawn $800 million of the $1 billion available under its swap line with the Federal Reserve.

Over the weekend, Mr. Coombs continued, the Bank of Italy had raised its discount rate from 4 to 5-1/2 per cent. That would generally be supplemented by a penalty rate of 1-1/2 per cent, making the effective rate 7 per cent. Bond yields were expected to move up to the 8-1/2 to 9 per cent range. Also, Governor Carli had reported at the BIS meeting that drastic restraints were being imposed on actual use of the discount window. He had asserted with confidence that the Bank of Italy had full and effective control of the money and credit supply, and that that would not be an inflationary factor. The main problem, as he saw it, was to ride through the balance of payments pressures caused by the strikes of last November and by unfavorable seasonal factors, until late spring when the tourist season and other favorable seasonal influences would produce a heavy flow of dollar earnings. Those earnings would help pay off indebtedness accumulated in the interim. The political and social situation remained a major question mark, however, and it could decisively influence the outcome for good or bad. On that score Governor Carli could give no prediction.

Mr. Coombs concluded by noting that he would have more to say about the Italian problem when he presented his recommendations.

> By unanimous vote, the System open market transactions in foreign currencies during the period February 10 through March 9, 1970, were approved, ratified, and confirmed.

Mr. Coombs reported that a $15 million drawing on the National Bank of Belgium would mature for the first time on March 24. He would recommend renewal of that drawing if it did not prove possible to acquire sufficient Belgian francs to repay it by maturity.

> Possible renewal of the drawing on the National Bank of Belgium was noted without objection.

Mr. Coombs said his second recommendation related to the Italian swap line, which now stood at $1 billion. Just before the February BIS meeting Governor Carli had indicated to the U. S. Treasury representative in Rome that he was becoming concerned about Italy's liquidity position and might have to ask for an increase in the swap line with the Federal Reserve. At the February BIS meeting Governor Carli had spoken to him (Mr. Coombs) in somewhat firmer terms, but had not yet been prepared to make a formal request for an increase. As the members would recall, at the February 10 meeting of the Committee he had asked for permission to discuss with the Treasury the question of whether the Treasury would be prepared to join with the Federal Reserve in a special credit package for Italy. He might note in passing that from the inception of the swap network it had been standard practice to obtain the views of the Treasury before adding particular central banks or increasing individual swap lines.

The Treasury's reaction had been one of qualified approval, Mr. Coombs observed. They had indicated that they might be prepared to extend a $250 million credit facility to Italy, and that they would have no objection to a $250 million increase in the Federal Reserve swap line, subject to the receipt of satisfactory responses by the Bank of Italy to two questions. The first was why Italy did not draw on its large creditor position with the International Monetary Fund; the second was why it did not take advantage of its unconditional right to draw $200 million on the recently established Common Market swap facility. Information on the Treasury's attitude had been conveyed to a representative of the Bank of Italy ten days ago.

At the Basle meeting this past weekend, Mr. Coombs continued, Governor Carli had made a specific request of Mr. Daane and himself for a new swap facility of $500 million. Governor Carli had indicated that from his point of view it did not matter whether the new credit was extended only by the System or jointly with the U.S. Treasury. As to the first of the Treasury's questions, Governor Carli had said he feared that the publicity attendant on a Fund drawing would have an unfavorable market effect. He added, however, that his request for a new swap facility was made on the understanding that any credits under it would be repaid by means of a Fund drawing if the current flows did not prove to be reversible in the near future. The U.S. Treasury had accepted that position.

Governor Carli had offered several reasons for his reluctance to use the new Common Market swap facility, Mr. Coombs observed. As with a Fund drawing, he was concerned about the effects of publicity; since this would be the first use of the facility a great deal of publicity could be expected. Secondly, the Bank of Italy was disturbed about the prospect of undertaking discussions of Italian credit policy in the Common Market at this time, in the absence of a government in Italy. Finally, Governor Carli noted that the other Common Market countries were not heavily supplied with dollars at present and thus were not in a good position to lend.

Mr. Coombs went on to say that Governor Carli had indicated that he would discuss the matter of possible U.S. credits to Italy with the Common Market governors at a meeting scheduled for yesterday (March 9), and with the European Monetary Commission today. Mr. Daane and he had asked to be informed about the outcome, and early this morning the representative of the Bank of Italy in Brussels had telephoned to report that the discussions had gone well. Italy's Common Market partners had no objection to the proposed request for further swap facilities with the Federal Reserve and/or the U.S. Treasury, and they understood Governor Carli's reluctance to draw upon either the Fund or the Common Market swap facility. They had indicated that if Italy did draw on the latter facility, some of its Common Market partners might have to make drawings on the Federal Reserve. He had relayed the substance of that report to Under Secretary Volcker this morning, and the latter had indicated that the Treasury would accept the Italians' position that it was inadvisable to draw on the Common Market facility at present.

Accordingly, Mr. Coombs said, he would recommend an increase in the Federal Reserve swap line with the Bank of Italy from $1 billion to $1,250 million, and a corresponding amendment to paragraph 2 of the authorization for System foreign currency operations. The Treasury was prepared to extend an equal swap facility. The proposed addition of $250 million to the Federal Reserve swap line would mature in December, along with the present $1 billion facility. The Italians were not seeking a permanent expansion of the facility at this time; rather, it was contemplated that the situation would be reviewed when the line matured. There was some urgency in the matter; partly as a result of the publicity recently given to the Italian situation, Italy had lost nearly $30 million yesterday and today's losses might be as high as $50 million. An early announcement of the expansion in U.S. credit facilities to Italy could be helpful in stabilizing the situation.

Mr. Daane said he had the impression that Governor Carli was reasonably optimistic about the lira and thought it possible that the new credit facilities might not have to be drawn on. Also, while Governor Carli had expressed the view that a drawing on the Common Market facility might be interpreted as a sign of weakness, the Governor felt that an increase in the Federal Reserve swap line would help to strengthen the lira.

In reply to a question by Mr. Mitchell, Mr. Coombs said the Bank of Italy had drawn the current total of $800 million on its swap line with the Federal Reserve in a series of four drawings of $200 million each that began in the latter part of January.

Mr. Mitchell then asked whether there was much risk that the current Italian drawings, like earlier British drawings, would remain outstanding for more than a year.

Mr. Coombs replied that in his judgment there was little chance of such a development, given the size of Italy's reserves and of its drawing rights in the Fund. The Italians were pursuing a course the United States had followed when faced with similar situations in the past; they were operating on the assumption that the current outflows were reversible, while planning to draw on the Fund if that turned out not to be the case. If the Italians were not able to repay their swap drawings at the end of the summer tourist season it would be evident that they were faced with a more basic problem than now appeared to be the case. He suspected that if Governor Carli had been asked to name a specific date by which a Fund drawing would be made to repay outstanding short-term credits, the Governor would have readily agreed to an end-of-summer date.

Mr. Daane said he shared Mr. Coombs' impression on that score.

Mr. Coldwell asked the Special Manager for his views about the stability of the Italian economic and political situations.

Mr. Coombs said he had no more information about the Italian political situation than one could get from the press. He thought there was nothing basically wrong with the Italian economy. Before the strikes of last November the lira had been one of the strongest currencies in Europe. Since that time the Italian current account had shifted from large surplus to a more balanced position, but that in itself was a useful development.

Mr. Solomon added that until very recently it would have been fair to describe the Italian balance of payments as one of the strongest in the world. In the past two or three years much of the discussion in Working Party 3 meetings had been directed at urging Italy to take measures to reduce its extremely large surpluses on current account. Those surpluses now had been reduced somewhat as a result of inflation in Italy. It was not ruled out that the process might proceed so far that Italy would find itself in Britain's recent position. At the moment, however, the surplus could be said to be moving down to a reasonable level. The major problem was a capital outflow stimulated in part by the political situation, but Italy's economic situation was still very strong.

After further discussion Chairman Burns said it might be desirable for him to make one final check with the Treasury, to ensure that all earlier questions had been resolved, before any action the Committee took in the matter became final. He proposed that the Committee vote on the recommendation to increase the Italian swap line to $1,250 million and to amend the foreign currency authorization correspondingly, subject to his determination that the action was in the national interest.

By unanimous vote, an increase of $250 million, to $1,250 million, in the swap arrangement with the Bank of Italy, together with the conforming amendment to paragraph 2 of the authorization for System foreign currency operations, was approved, subject to the understanding that the action would become effective upon a determination by Chairman Burns that it was in the national interest.

Secretary's note: Chairman Burns made the indicated determination later on the day of this meeting. Accordingly, effective March 10, 1970, paragraph 2 of the authorization was amended to read as follows:

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

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	200
National Bank of Belgium	500
Bank of Canada	1,000
National Bank of Denmark	200
Bank of England	2,000
Bank of France	1,000
German Federal Bank	1,000
Bank of Italy	1,250
Bank of Japan	1,000
Bank of Mexico	130
Netherlands Bank	300
Bank of Norway	200
Bank of Sweden	250
Swiss National Bank	600
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,000

Chairman Burns then invited Mr. Daane to comment more generally on developments at the Basle meeting.

Mr. Daane said he could be quite brief since Mr. Coombs had already indicated the substance of the discussions. At the Sunday afternoon session the Governors focused mainly on the three recent changes in discount rates. Governor O'Brien noted that the British move was designed to deter abnormal inflows attracted by London rates, without in any way relaxing the squeeze on the British banks. Governor Klasen of the German Federal Bank explained that their move was aimed at achieving a psychological impact they deemed necessary in the absence of other measures--

which had been proposed by the government but rejected--to deal with their inflationary problem. Absent such measures, the German authorities felt that a discount rate increase of the magnitude made was needed to demonstrate official determination to deal with the problem. Governor Carli offered a somewhat similar explanation for the Italian move, dismissing the rate itself as unimportant since the Bank of Italy was refusing all requests for discounts. He observed that the move was needed to show the public both inside and outside of Italy that they had the ability to act with respect to monetary and financial policy.

That evening at the Governors' dinner, Mr. Daane continued, he reported on the United States' economic and financial situation. In accordance with a suggestion by Chairman Burns, he had indicated to the group that the current System posture was one of beginning to probe cautiously towards somewhat less firmness. On the whole, he thought the Governors had received that explanation quite well. In fact, they seemed somewhat relieved that the System did not appear to be moving more aggressively, in a more major way. They did, however, raise a question as to whether any real diminution of inflationary expectations in the United States had occurred. Mr. Daane added that in connection with his indication of current U.S. monetary policy both he and President Zijlstra had stressed the essential confidentiality of the discussions in Basle among central bankers.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering domestic open market operations for the period February 10 through March 4, 1970, and a supplemental report covering the period March 5 through 9, 1970. Copies of both reports have been placed in the files of the Committee.

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

> Over the period since the Committee last met interest rates have moved sharply lower as the bullish market sentiment that had begun to develop in early February gained momentum. Continuing evidence of a weakening economy strengthened expectations that monetary policy would sooner or later be relaxed, and as the period progressed there was a growing conviction among market participants that some modest relaxation had in fact taken place.
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> Since reaching their peaks in December, yields on three-month Treasury bills have declined by about 1-1/4 percentage points. In yesterday's regular Treasury bill auction, yields on three- and six-month bills were established at 6.88 and 6.73 per cent, respectively, down 43 and 65 basis points from the levels established in the auction just prior to the last meeting of the Committee. Yields on Government securities in the 3-5 year maturity range have declined by about a full percentage point from their end-of-year levels. Most striking, the new 7-year 8 per cent Treasury note, which had not yet been issued at the time of the last meeting, is now trading at a premium of over 5 points, where it yields close to 7 per cent.
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> Despite a heavy calendar of corporate and municipal issues, rates in these markets have also declined by 1/2 to 3/4 percentage points, and the same is true of long-term Governments. With rates having moved so far, many market observers feel that a period of consolidation may now be at hand. There has been heavy individual buying and for a time institutional investor interest

picked up. But there also has been--as is typical of any period of sharp interest rate decline--a fair amount of speculative buying by dealers and other professionals. Not all recently issued securities have passed into the hands of final investors. At the same time, a further buildup of the calendar of corporate, municipal, and Federal agency financing is taking place as corporations seek to restore depleted liquidity, as municipal and State governments seek to catch up on their need for funds, and as the Federal housing agencies continue to support the mortgage market. In these circumstances, some pause in the decline of interest rates would not be surprising; indeed, there has been some technical rebound of rates in the corporate and municipal markets.

On the other hand, a continuing stream of evidence that the economy is weakening further, and official statements in reaction to that evidence, could convince markets that interest rates are bound to go considerably lower.

As far as open market operations are concerned, we were not notably successful in the first week of operations after the last Committee meeting in bringing about the easier money market conditions that the Committee desired. Despite massive injections of reserves through repurchase agreements, equally massive reserve shortfalls occurred over Lincoln's birthday and over the following weekend. Despite the resultant firmness in the funds market and the relatively high dealer borrowing costs, Treasury bill rates declined sharply--so sharply, in fact, that we felt compelled to avoid outright purchases of Treasury bills for fear of driving rates to unsustainably low levels. Subsequently, however, we were able to attain the money market conditions that we had been seeking. By the end of the period most market observers--although somewhat confused by the behavior of the aggregates--appeared convinced that the System had indeed moved to a somewhat less restrictive policy stance.

The aggregate measures that we are using to shape day-to-day operations turned out somewhat different from what had been expected at the time of the last meeting. Taken together, money supply and the adjusted credit proxy were quite weak in February and do not appear to be turning out quite as strong as the Committee had desired over the first quarter as a whole. Considerable strength, however, is anticipated this month and in April.

As far as the money supply is concerned, the February decline at a 10 per cent annual rate was substantially greater than the 2-1/2 per cent rate anticipated at the last meeting and offset the strong January rise. In March a 6-1/2 to 7 per cent annual growth rate is expected, bringing the growth rate for the quarter to about 2 per cent, compared with a 3-1/2 to 4-1/2 per cent rate expected at the time of the last meeting. While the money supply was weak, the bank credit proxy--at least in the projections--appeared to be gaining considerable strength. In February the proxy, adjusted for nondeposit sources of funds, is estimated to have declined at a rate of about 6-1/2 per cent, a shade better than the 7 to 9-1/2 per cent rate of decline projected at the time of the last meeting. More striking, however, was the changed outlook for March, which is now expected to show a 10 per cent annual rate of increase in contrast to the small decline expected four weeks ago. If the March projection turns out to be right, the proxy should show a small growth over the first quarter of the year rather than the 3-1/2 to 4-1/2 per cent rate of decline anticipated at the time of the last meeting.

How did these divergent trends in the aggregates--divergent both from earlier expectations and from the Committee's longer-run goals--affect day-to-day operations of the System Open Market Account? First of all, the over-all weakness in the aggregates in February made us quite aggressive in ensuring the achievement of less firm conditions in the money market. However, the growing strength in the credit proxy projected for March and April--perhaps a lagged response to the less firm conditions being achieved in February--made us hesitant to push too much further down the path of less firmness. The sharp decline in interest rates that occurred over the period also cautioned against overly aggressive action at the Trading Desk, because of the danger that rates might be pushed to unsustainably low levels. As mentioned earlier, this concern led us to avoid outright purchases of Treasury bills at the time rates were undergoing their sharpest decline, and it also led us to offer at least a token resistance through matched sale-purchase agreements when the Federal funds market became too easy on the final day of the last two statement weeks and again yesterday.

Looking at the aggregates as they are expected to develop through April, we would have by then (if the projections are right, for which there is no guarantee) a growth rate for the first four months of the year of about 2 to 2-1/2 per cent for both bank credit and the money supply. This is a somewhat weaker performance of the money supply than had been anticipated earlier, but a far stronger performance of bank credit, which is expected to grow at about a 9 per cent rate in March and April combined. I note that, assuming unchanged money market conditions, the blue book[1/] projects only a 5 per cent growth rate for bank credit over the entire second quarter. This appears to be on the conservative side, particularly with the assumption that short-term interest rates should move seasonally lower as the Treasury repays debt later this spring. The Committee may well have to face a resurgence of bank credit if banks regain their role as intermediaries. Much will depend, as the blue book points out, on how much banks will improve their liquidity by paying off other borrowing--i.e., Euro-dollars or commercial paper--rather than expanding assets with the proceeds of new CD's. And to these questions there can certainly be no final answers now. But the spreading conviction that still lower interest rates lie ahead might well tempt banks to add to investments as well as to realign liabilities.

In response to a question by Mr. Hickman, Mr. Holmes said the Desk had undertaken matched sale-purchase agreements on several occasions when the Federal funds market had become quite easy in order to reduce the risk that the market would overestimate the degree to which monetary policy had been eased. As he had noted, however, only token resistance had been offered to declines in the funds rate and no effort had been made to push the rate back up.

Mr. Maisel noted that in earlier periods of slowing activity the normal relationship between the money stock and bank credit had tended to break down. Specifically, the money stock had tended to

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

weaken relative to bank credit in such periods. He asked whether that was not likely to be the case in the months ahead.

Mr. Axilrod replied that in his judgment, as he would note in his report later, there was a possibility that it would prove difficult to achieve modest growth in the money supply over coming months at a time when there might be considerable growth in time deposits and possibly also bank credit. It was true that there had been simultaneous rapid expansion in money and bank credit in early 1967 and late 1968, but the economy had been considerably stronger in those periods than it was now. Although the staff was projecting modest growth in the money supply in both the first and second quarters, it might be that the underlying situation was weaker than those projections implied. A good part of the growth in money supply anticipated in the first quarter was attributable to an expected temporary bulge at the end of March related to the effects of the four-day Easter holiday abroad; and much of the expected second-quarter growth was associated with declines in Government deposits.

Mr. Partee added that the growth rate of money in a period of slackening activity also depended to an important extent on the posture of monetary policy. As Mr. Axilrod had noted, the rapid growth in early 1967 was explainable in part by the strength of the economy then; but it was also explainable in part by the vigorous easing in monetary policy--which, among other things, had helped to precipitate a sharp drop in short-term interest rates.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period February 10 through March 9, 1970, 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 which have been placed in the files of the Committee.

Mr. Partee made the following statement concerning economic developments:

The cyclical configuration of the economy has become much more pronounced in the four weeks since the Committee's last meeting. Incoming business statistics have almost all been weaker--in some cases, dramatically so. Housing starts and building permits were very weak in January, and the weekly retail sales figures for February suggest another poor month in this area, despite a rebound in new car sales toward the end of the period. The unemployment rate, as we all know, moved sharply upward again last month, with the increase over January occurring solely among adult workers and concentrated in manufacturing. Equally significant was the drop in the manufacturing workweek, which was off 0.4 of an hour in January and by the same amount again in February. As a result of the further widespread decline in labor input, we are now estimating that the industrial production index dropped 0.7 per cent further in February, despite resumption of work at General Electric. This would bring the decline in the production index to about 3.5 per cent over the past seven months, an annual rate of around 6 per cent.

These statistics indicate a spreading and intensification of the decline, and this is also suggested by the fact that both the leading and coincident indicators are now moving downward. The question is rapidly shifting from one of whether or not we are in a recession to how deep and protracted it will prove to be.

The staff is still optimistic on this score. We believe that there should be some resurgence in consumer buying in the spring, based on the special income supplements coming from the Federal Government, that there is little reason to expect an extended period of inventory adjustment if the improvement in consumer buying occurs, and that business capital expenditures are likely to continue rising for at least some months to come. Looking further ahead, and assuming an easing in the financial situation, we would anticipate a rebound in housing and in State and local government capital expenditures to offset the continuing decline in defense industry activity and a possible leveling off in business plant and equipment spending. The result would be two more quarters of decline in real GNP, followed after mid-year by the resumption of a moderate rate of growth in over-all economic activity.

This longer-run outlook is based importantly on the proposition that there are pent-up demands for housing and other capital goods which will be released, with a lag, after financing again becomes available. I am confident that this is so. In the short run, however, I believe that all of the risk in the staff projection is on the downside. Two main areas where our expectations for the first half could be too optimistic are inventory investment and housing.

With regard to inventories, the January increase in book values in manufacturing, at a $3 billion annual rate, was substantially slower than during the fourth quarter. Automobile stocks dropped sharply further in February, and the over-all decline indicated for industrial production suggests that rates of inventory accumulation in other industries generally may have continued moderate. As cutbacks in production of final consumer products--mainly durables--spread to supplier industries, as now appears to be occurring, further adjustments in inventory levels through output reductions would appear to be the logical expectation. This process seems now to be well in train, in which case our projections of continued inventory accumulation at $6 billion and $3.5 billion rates in the first and second quarters, respectively, could be too high. Lower rates of inventory investment would speed the adjustment of excess stocks, of course, but they would also tend to bring higher unemployment and slower growth in aggregate incomes than we had bargained for.

With regard to housing activity the situation looks more ominous. Starts in January declined 7 per cent, to slightly under a 1.2 million annual rate, but building permits plummeted by nearly one-fourth. Outstanding mortgage commitments are dropping rapidly at all of the types of institutions for which we have figures, and everything we know about savings flow experience early this year suggests that new private mortgage commitments are probably very hard to come by. In this connection, it is important to remember that commitments need to be generated some months ahead of the starts they finance. Federal National Mortgage Association commitment activity remains high and Home Loan Bank Board lending policy liberal, of course, but these sources cannot support the whole market. All in all, it seems possible that not enough money has been forthcoming to finance even the one-million-starts rate we have projected for the second quarter. The downside risk is especially great since the seasonal factors require close to a doubling in second-quarter starts from the January unadjusted rate just in order to stay even.

New evidence of the underlying strength of demands for business capital goods, on the other hand, is provided by the latest Commerce-SEC survey of capital spending plans, to be released tomorrow. This survey indicates that business is planning an increase in dollar outlays for plant and equipment this year of 10-1/2 per cent. The increase is actually a little higher than that reported in the special year-end tabulation, but I am informed that the surveys are not comparable because of differences in the adjustments for reporting bias. On an unadjusted basis, the new survey shows a reduction of more than $1 billion from earlier spending plans. It should be noted also that fourth-quarter 1969 expenditures turned out to be unchanged from the third quarter, whereas a sizable increase had been expected. This was the sixth consecutive quarter of shortfall from earlier intentions.

As expected, the current survey shows large increases in the outlays planned in 1970 by public utilities and communications companies, and by railroads and air transport as well. But the big surprise is that manufacturers reported that they are planning a 10 per cent increase in capital spending for the year as a whole. The increase is not scheduled for the first half of the year, when outlays are expected to rise only 2 per cent, but shows up by implication in the second half, when a further rise of 8 per cent would be required to reach the reported totals for the year. The probabilities of such a speedup seem to me very dubious. It is not suggested by the fourth-quarter report of the National Industrial Conference Board on capital appropriations of manufacturers, nor is it consistent with recent declines in new orders for machinery and equipment. More fundamentally, in view of the near-term prospects for sales, profits, and capital utilization rates, any early resurgence in the trend of capital spending in the manufacturing area seems to me inconceivable.

In sum, we know that business activity is declining currently, and that there are some signs of a spreading and intensification of the decline. It appears also that some areas in the short-run outlook--notably, inventory investment and housing--may be weaker than the staff has projected. Finally, we should underscore that our expectations of a brief and relatively shallow recession are heavily dependent on an upturn in consumer spending in the spring, and in housing and State and local government capital expenditures later on. The first of these factors will be influenced by consumer attitudes, which have been notably unfavorable this past winter, and the other two require a freeing up in financial flows soon, in view of the lead times involved. All of these considerations, I believe, point to the desirability of a further decline in interest rates and of an early resurgence in savings flows to the financial institutions. Some additional easing in monetary policy, in my view, is essential to the achievement of these goals.

Mr. Axilrod made the following statement concerning financial developments:

The Committee's action of a month ago appears to be leading to some moderation of restraint in financial markets, as intended--although there is some question as to how much of the moderation reflects expectations, how much weakening business, and how much an actual change in the monetary aggregates directly influenced by monetary policy. The most spectacular change in financial markets has been the very sharp declines of interest rates--both short- and long-term--from late 1969 peaks; the mortgage market, where yield adjustments do lag, thus far is the exception to this trend. Following a very large run-up in yields in 1969, generally ranging from 150 to 250 basis points, interest rate declines have ranged from around 60 to 90 basis points for long-term rates to around 125 basis points for Treasury bill rates, with some of the decline in rates in process prior to the previous FOMC meeting.

It was not, however, until the statement week just past that money market conditions, as indicated by member bank borrowings and net borrowed reserves, showed clear signs of a reduction in restraint on banks' marginal reserve positions, although the Federal funds rate itself had dropped somewhat in the week before. Thus, it would appear that long-term interest rates had begun to decline before tangible signs of an easing in the stance of monetary policy became evident in the narrow money markets.

With the volume of security offerings in bond markets heavy in February, one would tend to conclude that expectations have been an important force driving intermediate- and long-term interest rates down. Recognizing that an extremely large volume of new corporate bond issues is in prospect for March and that a sizable flow of municipal and Federal agency issues will continue, it seems likely that bond yields could back up from current levels unless expectations are confirmed by an actual and noticeable improvement in the availability of funds for investment, particularly from banks, but also from thrift institutions, insurance companies, and other financial institutions.

There do appear to be signs of an improved flow of funds into banks, particularly in time and savings deposits at banks outside major money centers. In addition, attrition of large-denomination negotiable domestic CD's at money market banks appears to be halting, while foreign time deposits continue to rise, though the latter in part substitute for Euro-dollars. The new Regulation Q rate ceilings adopted by the Board in late January appear to have been of help to banks, especially in light of the recent declines in market interest rates. Moreover, large banks continue to be active in the commercial paper market, with the late-February announcement by the Board, further postponing regulatory action in this area in order to avoid additional stringency in money and credit markets, generally regarded as consistent with a monetary policy moving toward less restraint.

On a seasonally adjusted basis, total time and savings deposits at all commercial banks grew by a little over $1 billion from the last statement week of January to the last week in February, the first rise of that magnitude since December 1968. Early data for March suggest a continuation of that trend, and should that develop, the annual rate of increase for time deposits from the February average level to the March average level will show a very considerable plus. There also appears to have been some improvement at thrift institutions after January, although partial data do not suggest nearly so large a shift toward net inflows as at banks. Savings and loan associations, as a matter of fact, were forced to borrow contra-seasonally from the Home Loan Banks in the first three weeks of February.

If the improved time deposit inflows to banks continue, this will put banks in a position once again to become sustained net purchasers of securities, and will thereby tend to maintain long-term yields at reduced levels--and quite possibly help push them down further. Given the current economic conditions as described by Mr. Partee, one would think that a further decline in long-term market interest rates is desirable. To provide an offset to weak consumer buying and declines in industrial production, it would appear desirable to begin to release, in a relatively controlled way, the pent-up demands for State and local services and housing before the current economic adjustment goes much further.

To turn housing around--and this probably cannot be accomplished without a lag of some months--will probably require further declines in short-term market interest rates, so as to make savings and loan association deposits a more attractive alternative to savers. And it will require further declines in long-term market interest rates, so as to raise the spread of mortgage yields over such rates to the point where financial institutions with diversified portfolios become much more interested in diverting funds to the mortgage market; this may take a considerably wider spread than has obtained in recent months, perhaps one up in the 50-100 basis point range.

A further easing in financial markets could lead to a very sharp rise in banks' time deposits as the new Regulation Q ceilings become more fully competitive.

Whether bank credit would expand equally dramatically is difficult to predict, since it is by no means clear to what extent banks will substitute time deposits for commercial paper and Euro-dollars. But the economic circumstances of today are not those of mid-1968, and I would not be excessively worried by strong bank efforts to reintermediate and attempt to regain their much eroded market position, provided that the money supply does not at the same time grow very rapidly.

In the first half of 1967 and the second half of 1968, when bank time deposit growth was extremely strong, the money supply grew at annual rates of between 6-1/2 and 7 per cent. A repeat performance of those two episodes seems obviously undesirable. But the economy has been strapped for liquidity for so long now that a money supply growth in a 3 to 4 per cent annual rate range would seem to be reasonable, should it develop or be required as credit markets as a whole are moved to a position that is more encouraging of spending. If the economy were to turn very weak, however, it should be recognized that reasonable and desired money supply growth, strongly influenced as it is by transactions demands, might be difficult to sustain without encouraging rather sharp drops in interest rates, and perhaps associated with this, very rapid expansion in time deposits and bank credit.

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

For a considerable period of time, domestic and balance of payments considerations have been thoroughly in accord in pointing the way for monetary policy. We are now entering a period when there will appear to be some conflict between domestic and external objectives. I propose today to put before the Committee several propositions on the role of balance of payments considerations in the formulation of monetary policy. I put these propositions forward in order to help the Committee focus on the issues involved in deciding how much weight to give to the balance of payments in making policy decisions.

A major reason why domestic and balance of payments considerations have pointed in the same direction is that our external position could stand only to gain from success in the domestic battle against inflation. The precipitous reduction in the U.S. trade surplus in recent years was the result mainly of soaring American imports. Our imports almost doubled between 1964 and 1969 under the impact of excess demand and probably also of the rise in U.S. prices relative to prices abroad. The elimination of excess demand, now accomplished, has shown up in a leveling off of U.S. imports. What remains to be accomplished is to decelerate the rate of price advance--again for both domestic and balance of payments reasons.

Meanwhile, the monetary restraint that was so appropriate for these reasons was having the by-product effect of inducing American banks to borrow heavily from their branches. This in turn drove up interest rates in the Euro-dollar market, and led to a large shift by foreigners out of their own currencies into Euro-dollars. This heavy demand for dollars by private foreigners kept the dollar strong in foreign exchange markets, depleted the dollar holdings of foreign central banks, and showed up as a surplus in the balance of payments on the official settlements basis.

Now that monetary policy is moving the other way--for essentially domestic reasons--it is desirable to bear in mind both the long-run balance of payments effects, which will depend on income and prices in the United States, and the immediate effects on capital flows, which will depend on relative interest rates.

With all this as background, my first proposition is that while tight money may have been good for the balance of payments, monetary policy that is too tight for too long is not good for the balance of payments. A recession, apart from its undesirable domestic effects, would be accompanied by a sharp increase in capital outflows, despite the various Governmental restraints on such outflows. Also, the inflow of foreign funds into U.S. equities would probably be discouraged. Finally, we know that a recession might be followed by a forced draft recovery, with an attendant revival of inflationary pressures.

Thus, balance of payments considerations support the domestic case for relaxation of monetary policy now that excess demand has been eliminated.

My second proposition is that once enough relaxation has been achieved to permit the monetary aggregates to expand at a rate that is within the range of what is sustainable, balance of payments considerations would weigh in on the side of caution. This is so because of the urgency of ending inflation and because of the desirability of protecting against too massive a capital outflow.

My third proposition is closely related to the second one, since it concerns the rapidity of the re-expansion that should be sought in the latter part of this year and in 1971. I doubt that there is much difference between domestic and balance of payments criteria on this matter. We cannot expect the economy to remain flat for long. But balance of payments considerations underline the desirability of avoiding another burst of excess demand in the U.S. economy.

My fourth proposition relates not to the posture of monetary policy but to the Federal Reserve and Commerce Department restraints on U.S. capital outflow. Since the dollar has been so strong in foreign exchange markets, a euphoria has developed over the balance of payments problem and has led a number of observers to recommend that these restraints be scrapped. Some people ring in the two-tier system for gold prices and argue that since the world is now effectively on a dollar standard, we need not maintain these distasteful controls on capital flows.

It seems to me that these views are based on a misreading of what has happened in the world. The fact that the United States has sold very little gold since March 1968 is not a result of the two-tier system but mainly reflects the coincidental movement of the U.S. balance of payments into large official settlements surplus beginning in the second quarter of 1968. The main reason our gold sales have been so small is that foreign central banks have experienced a drain on their dollar holdings. This happened as a result of tight money in the United States.

Thus, my fourth proposition is that, with monetary policy moving away from severe restraint, the need to maintain the restrictions on capital outflow is compelling. Even with the restrictions in place, our balance of payments will show a large deficit this year. Furthermore, as is spelled out in the green book,1/ credit conditions

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

> in Europe will be rather tight for some time to come, so that both U.S. investors abroad and foreign borrowers will have an incentive to shift to the U.S. market as a source of funds. In these circumstances, the existence of the capital outflow restrictions helps to give monetary policy leeway to relax for domestic reasons without causing an intolerable flow of dollars abroad.

At Chairman Burns' suggestion the Committee then engaged in a general discussion of current and prospective economic and financial conditions. The subjects commented upon included the outlook for fiscal policy and for various components of final demand, the probable magnitude and duration of the current slowdown in economic activity, the state of inflationary pressures and expectations, the recent and prospective behavior of long-term interest rates, the possibility of large-scale reintermediation by banks and of rapid growth in bank credit, the uses to which banks were likely to put additions to their time deposit balances, and the possibility that monetary aggregates would fall short of projections in coming months, as they had in past periods of economic weakness.

In the course of the discussion Mr. Hickman referred to Mr. Partee's comment about possible overstatement in the projections of inventory accumulation for the first two quarters, and said he thought the more relevant question concerned the change in inventory accumulation between quarters. There had been some evidence of late which seemed to indicate that the decline in inventory accumulation from the first to the second quarter might be less than had been previously anticipated.

Mr. Hayes expressed the view that, while the economy clearly was continuing to cool, there was no convincing evidence of a cumulative contraction. In general, the outlook seemed stronger to him than the Board staff's analysis suggested. He was impressed by the indications of strength in prospective outlays on plant and equipment; by the enormous pent-up demands in the areas of housing and State and local government expenditures; and by the real possibility that Federal spending would not be held down to the budget levels. He had not heard any arguments which persuaded him that inflationary pressures were abating, and he thought prospects were for continued large wage settlements. The possibility that shifting expectations would lead to further large declines in interest rates concerned him, partly because rates might be carried below the levels appropriate to the underlying economic situation and partly because of the balance of payments implications of such rate declines.

Messrs. Coldwell and Heflin both expressed the opinion that inflationary expectations, while still present, had diminished recently. Mr. Heflin noted that he considered the pent-up demands to which Mr. Hayes had referred mainly as a source of protection against a sharp downturn in the economy, although they did suggest that the System should not move too rapidly in the direction of easing. Mr. Galusha remarked that the objection of policy was not to slow spending by everyone but only by enough people to produce the desired results over-all.

He noted that both District and national data left little doubt in his mind that the recent policy stance was having a restrictive effect. Mr. Mitchell observed that the effects of policy were clearly evident in the production and employment statistics. He was not disturbed by the limited extent to which price pressures had abated thus far since he expected prices to react with a lag, although the length of the lag was highly uncertain.

In commenting on prospective financial developments Mr. Morris remarked that it would be helpful to the Committee to have a better theoretical structure for assessing the significance of particular changes in money flows--such as fluctuations in the volume of commercial bank time deposits as the relationships shifted between market interest rates and Regulation Q ceiling rates, and changes in the use of nondeposit sources of funds by banks. Mr. Axilrod noted that the implications of such changes had been the subject of much debate by economists in recent years. His own predilection was to consider large changes in, say, the volume of CD's outstanding as primarily reflecting substitutions by investors between such instruments and other kinds of market paper, rather than as indicative of changes in the over-all supply of funds. In any case, the staff would explore means of improving the blue book analyses of funds flows, although the amount of improvement that would be feasible in the short run might be limited.

At the conclusion of the discussion Chairman Burns said it seemed to be agreed that there were recessive tendencies in the economy at present. The crucial question for the Committee to decide was how serious those tendencies were. In the course of his own analysis he had been impressed by the speed with which the unemployment rate had risen in the past few months and by the widespread nature of employment declines among manufacturing industries--even though the unemployment rate had not reached an unusually high level and the manufacturing employment declines were not particularly large. As to the backlog of pent-up demands, it was important to distinguish between those that were already effective and those that could become effective when credit was more readily available. The only available indicator of the former was the series on unfilled orders, and that had been declining in recent months. While the volume of the latter appeared to be very large at present, history suggested that demands of that type could vanish quickly if economic activity declined. The latest surveys of plant and equipment spending plans did suggest strength in the outlook for capital investment, but recent data on manufacturers' appropriations and on new orders for machinery and equipment pointed in a contrary direction. It had been his experience that better forecasts of capital spending could be made from new orders and appropriations figures than from surveys of business spending plans, and that the latter were least reliable in a period of transition. He was highly dubious that capital spending would remain strong throughout 1970 and would accelerate in the second half of the year, as suggested by the Commerce-SEC survey.

Chairman Burns commented that in his opinion fiscal policy currently was strongly restrictive. However, in response to a question by Mr. Galusha he expressed the view that, if the weakening in the economy became pronounced and monetary policy remained highly restrictive, within a few months there was likely to be an increase in Federal spending so large as to carry a real danger of a resurgence of inflationary pressures. He made that statement with confidence, on the basis of intimate knowledge of the thinking of members of the Administration and some knowledge of Congressional thinking.

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

> While it seems quite clear that the economy continues to cool down, there is as yet no convincing evidence that a cumulative contraction is developing. Inflation is still the overriding problem, and I think this should preclude any further movement at this time toward still less monetary restraint.
>
> The Committee's desire to see moderate growth in the money and bank credit aggregates over the coming several months is a proper policy objective. Monetary policy should neither press so hard as to run the risk of causing an excessive downturn of the economy, nor restimulate major expansionary forces prematurely as long as inflation has not been brought under control.

At the same time, we should guard against contributing to excessive interest rate declines beyond levels justified by the underlying state of the economy. Balance of payments considerations would also argue against excessively sharp rate movements.

In essence then, I would favor continuing the policy of somewhat lesser restraint stipulated in alternative A of the directive drafts[1/] suggested by the staff. As far as aggregates are concerned, growth rates in both the credit proxy and money supply in the 2 to 2-1/2 per cent range, which the projections indicate are possible over the first four months of the year, would be acceptable.

My own specifications with regard to money market variables would be close to those given in the blue book in connection with alternative A.[2/]

I would use the proviso clause to move towards less restraint if the aggregates appear to be turning out weaker than desired and projected. But on the other side, I would be more concerned about more rapid growth in the credit proxy than currently projected for March and April than I would about some modest short-fall in the money supply, since the prospect for achieving the desired growth over the next three months appears good.

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

2/ The blue book passage referred to read as follows: "Less restraint in the money markets developed gradually over the past few weeks, and less firm money market conditions may now be taken to encompass a Federal Funds rate generally averaging in an 8 - 8-1/2 per cent range, net borrowed reserves generally in a $650-$850 million range, and member bank borrowings averaging $800-$900 million. If money market conditions are held quite close to those prevailing in the statement week just past, the 3-month bill rate might be expected to move downward within a 6-5/8 - 7 per cent range as the market's expectations of somewhat less restraint in money market conditions appear to be confirmed. It is quite possible that the bill rate could drop below the bottom of this range if market expectations of more easing develop, or if behavior of the monetary aggregates indicates to the Account Manager that he should shade money market conditions toward the lower end of the specifications...."

Mr. Morris said he thought the Committee was moving too slowly on policy. Recent experience demonstrated the weakness of the present directive, with its primary emphasis on money market conditions. Such a formulation was, he suggested, especially inadequate at business-cycle turning points.

In Mr. Morris' view the recent substantial declines in interest rates were solely the result of economic developments and changes in expectations; they could not be attributed to monetary policy. In support of that thesis, he noted that all of the major monetary aggregates--including total bank reserves, M_1, M_2, and the bank credit proxy--had declined on average between December and February. If the economy had been stronger the Manager, operating under the directives issued, would have supplied more reserves. The fact that the aggregates were falling short of the Committee's objectives suggested that the economy was weakening at an accelerating rate.

Mr. Morris noted that alternative A of the directive drafts called for maintaining the money market conditions "that have been attained." That alternative was unacceptable to him because, under conditions of a declining economy, it would represent a tightening move. He questioned seriously whether the second-quarter growth rates projected by the staff under alternative A[1/]

1/ As shown in the blue book, these projections were for growth at annual rates of 3 and 5 per cent for the money supply and the adjusted bank credit proxy, respectively.

would be realized if that alternative were adopted. In his judgment, to get modest growth in the aggregates it was likely to be necessary to continue easing money market conditions gradually. Accordingly, assuming the Committee planned to retain the present form of its directive, he would support alternative B.

Mr. Coldwell remarked that he interpreted the objective underlying the Committee's recent policy stance as that of creating uncertainty. In his judgment that objective had been achieved, and the need now was to maintain the uncertainty until inflationary expectations had cooled. At the same time, however, the Committee had to temper its actions to avoid a cumulative recessive movement.

Mr. Coldwell said he had been quite interested in the Chairman's earlier comment to the effect that fiscal policy could swing rapidly to substantial ease if the economy continued to weaken and monetary policy did not show some response. In his (Mr. Coldwell's) opinion that prospect suggested that the System should provide some overt sign of a change in policy. But rather than relying on open market operations, it might be better to provide that sign through another change in Regulation Q ceilings or perhaps through a public statement by the Chairman.

Turning to the directive, Mr. Coldwell said he had a certain amount of sympathy with Mr. Morris' comments, but for the present he would prefer to stay with something like alternative A. However, he would favor rewording the staff's draft to call for "accommodating the trend toward somewhat less firm money market conditions that has been attained...."

Mr. Swan remarked that the moderate growth rates in money and bank credit on which the Committee had agreed at the previous meeting had not been achieved. He saw no reason to change the interpretation of "moderate" growth. Like Mr. Morris, however, he thought it would be necessary to move to the money market conditions specified under alternative B in order to achieve the desired growth rates.

Mr. Galusha said he would submit the statement he had prepared for inclusion in the record. He noted that he also supported alternative B, since he thought it was important that growth in the aggregates be maintained at rates close to the targets set forth in staff's February chart show. The statement he had mentioned read as follows:

> What if monetary policy and fiscal policy turn out to be what the Board staff assumed they would be? Will its projections then be realized? As the Board staff and I agree, the one risk worth worrying about is that plant and equipment spending will be higher than projected, particularly over the second half of 1970. If so, then residential construction spending should be lower than projected. For with the assumed rate of growth of the money stock, higher than projected plant and equipment spending will mean higher than projected interest rates and, in consequence, lower than projected residential construction spending. Obviously, however,

GNP would likely increase more than has been projected in the third and fourth quarters of the year and an appreciable slowing in the rate of inflation, so long desired, would be delayed.

In making up our minds about Committee policy, we must then first decide how much to trust the Board staff's projection of plant and equipment spending. My judgment, for what it is worth, is that we should go with the Board staff's projection. I doubt that actual plant and equipment spending is going to exceed projected spending, at least by an amount worth worrying about. It could well be lower than projected spending.

One way of deciding the proper monetary policy is as follows: Take the Board staff's projections of Government and plant and equipment spending as being right. Then, depending on how actual monetary policy compares with the policy assumed by the Board staff, the unemployment rate will be either higher or lower than projected at, say, year-end. If the money stock grows more slowly than assumed, the unemployment rate will be higher; and if the money stock grows more rapidly, this rate will be lower.

The point is that the Board staff has for some time now been projecting an average unemployment rate for the last quarter of 1970 of 5.1 per cent. This is, by current political standards, rather a high average rate. But monetary policy has been more restrictive than the Board staff assumed it would be. Thus, at the February chart show the staff assumed, if implicitly, that the money stock would increase at an annual rate of 5 per cent in the first quarter of 1970. But even if the currently projected March increase is realized, the actual annual rate of increase will be 2 per cent. Rather a considerable short-fall, I should say. Also, the staff assumed, again implicitly, that the adjusted bank credit proxy would increase at an annual rate of 1 per cent in the first quarter. But even if the projected March increase is realized, the actual annual rate will be 0.5 per cent.

I might add that if money market conditions remain what they were in the statement week ending March 4 (which is rather considerably easier than they were in the preceding statement week), then the actual annual rate of increase for the adjusted bank credit proxy will be lower than assumed in the second quarter of 1970: 5 per cent versus an assumed 7 per cent. The actual and assumed rates of growth of the money stock will be the same, 3 per cent. But the actual increase will be from a lower-than-assumed base, so by mid-year both the money stock and the adjusted bank credit proxy will be below their assumed values.

All of which leads to the following conclusion: I believe the Board staff's projections for Government and plant and equipment spending are about right; I am, therefore, for even easier money market conditions. The prospect of an average unemployment rate of 5.1 per cent is not comforting; I am for alternative B of the staff directives.

It may seem strange--in light, that is, of recent criticism of the System for making excessively sharp changes in policy--that you should be asked to consider a sharp change (over a brief period) in money market conditions. The System's critics would point, however, to what they think of as excessively sharp changes in the rate of growth of the money stock. They would argue that such changes as there have been in money market conditions (or market interest rates) have not been sharp enough. Soon they will be arguing that the money stock increased too slowly over the first quarter (or half) of 1970 because the FOMC was unwilling to contemplate a sufficiently abrupt change in money market conditions.

The point is that to keep the money stock increasing at a more or less steady rate, sharp changes in money market conditions (sharper changes than the Committee is accustomed to) can be required. In present circumstances, the aim is to increase the annual rate of growth of the money stock from zero to, say, 3 or 4 per cent. This is a big change to be accomplished when the rate of increase of GNP is declining. (And a decline in the rate of growth of GNP will, if nothing is done, automatically produce a decline in the rate of growth of the money stock.) It should not therefore be surprising that a sharp change in money market conditions is evidently called for.

Mr. Baughman remarked that the economic projections contained in the green book seemed to him to be reasonable, both as projections and as targets for economic policy. He also supported the associated goal of moderate growth in the monetary aggregates, and he found the blue book projections in that area to be acceptable. Under present circumstances he would favor focusing on demand deposits or the money stock. He would not be disturbed by a rapid increase in bank credit, particularly if it were based on growth in time deposits.

Mr. Baughman added that he thought there was little difference between alternatives A and B for the directive or between the projections associated with those alternatives. Accordingly, he had no strong preference between them.

Mr. Clay said that in his opinion the Committee had to walk a very narrow path if it were to maintain the appropriate policy posture in the months ahead. He felt that moderate expansion in the aggregates was appropriate in view of the current and prospective state of the economy. On the other hand, price inflation and expectations remained serious problems, making it important to avoid too rapid growth in the aggregates. The Committee had to be careful not to lose the substantial progress it had already made against inflation. On balance, he would favor seeking growth rates in the aggregates near the upper ends of the ranges projected under alternative A.

Mr. Heflin said he still viewed the policy course the Committee had set at its previous meeting as essentially correct and he wanted to continue on that course in the weeks ahead. Some positive program to reverse the recent heavy attrition of the economy's liquidity was needed, but efforts in that direction had to be gradual. In particular, it was necessary to avoid even the suspicion that the System would embark on the kind of massive easing that had characterized its response to past slowdowns. He favored growth rates for the monetary aggregates like the blue book projections associated with alternative A.

Mr. Mitchell said he was somewhat troubled by the sentence in the first paragraph of the draft directive reading "Both bank credit and the money supply declined on average in February, but both were tending upward in the latter part of the month." Since so little was known about the determinants of short-run fluctuations in the money supply, he would favor revising that sentence to read "Both bank credit and the money supply moved erratically in January and February, but both were tending upward in the latter part of February and early March."

In his judgment, Mr. Mitchell continued, the next overt change in monetary policy should be another increase in Regulation Q ceilings on large-denomination CD's, for the purpose of encouraging reintermediation by banks and renewed bank investment in tax-exempt securities. With respect to the Committee's directive, he would prefer alternative A to B. In particular, the growth rates in the aggregates associated with alternative A were satisfactory to him. However, since one could not be sure what money market conditions would be needed to produce those growth rates, it might be desirable to invert the structure of the second paragraph--framing the primary instruction in terms of the desired growth rates in money supply and bank credit.

Mr. Daane said he would favor demonstrating the flexibility of monetary policy by continuing to move cautiously and gradually toward somewhat less restraint. But while he did not favor a "standstill" policy as implied in alternative A, he would not want to overstimulate expectations or to foster overly sharp further declines in market interest rates and a massive increase in the money supply, broadly defined. There was a risk that actual conditions would quickly outrun those projected in the blue book if the market overestimated the amount of easing intended. Thus, while he was inclined toward alternative B rather than A for the directive, he would not want to have B interpreted very aggressively.

Mr. Daane added that alternative B would express better the essence of the policy course he had in mind--that of the Committee's continuing to feel its way--if the language shown in the staff's draft was amended somewhat. Thus, instead of calling for operations "with a view to continuing to move gradually toward less firm conditions in the money market," he would call for moving "cautiously and gradually" toward "somewhat" less firm conditions in the money market--or perhaps "toward somewhat less restraint." Amendments of those types might help make it clear that the Committee intended at this juncture neither to stand still nor to rush headlong down the road to monetary ease.

Mr. Maisel said he agreed with Mr. Mitchell's suggestion for inverting the clauses of the second paragraph of the directive, so that the primary instruction would call for seeking moderate growth in the aggregates. In his judgment the Committee's most important task today was to decide on the growth rates in the aggregates that should be sought. For the rest of the current half-year, he thought that annual growth rates of 3 to 4 per cent in M_1 and of 7 to 8 per cent in the bank credit proxy would be proper.

Mr. Maisel remarked that a major problem in achieving those targets became evident when one examined the ratios of changes in M_1 and the bank credit proxy during prior cyclical downturns. History showed that the normal relationship between the money supply and total bank credit did not hold in such periods; the ratio of growth in money to growth in total bank credit was usually far smaller than normal.

As the year progressed, Mr. Maisel continued, the Committee would have to examine that relationship very carefully and determine how to alter the total if the components varied greatly. For the time being, however, he favored retaining as targets the growth rates for the aggregates projected under alternative A, recognizing that the Manager would have to change money market conditions from those recently prevailing if the increase in the aggregates was falling below the projections. In his view it was particularly important that a minimum growth rate of 3 per cent be achieved in the money supply, since a weak M_1 could be an indication that the economy was weaker than the Committee desired.

Mr. Brimmer said he had no quarrel with the staff's assessment of the economic situation. As he saw it, the key question was how much of a recession the Committee members were willing to risk in combatting inflation. He suspected that he was willing to risk a little more recession for that purpose than some others around the table.

At present, Mr. Brimmer observed, he favored maintaining unchanged the policy the Committee had agreed upon at the last meeting. It was not clear to him, however, whether that could best be accomplished by retaining the second paragraph of the directive issued on February 10 or by adopting alternative A of the drafts the staff had submitted for consideration today.

Mr. Partee commented that the choice would seem to depend on the meaning intended by an "unchanged policy". If the objective was to continue the gradual movement to less firm money market conditions that had been agreed upon in February, it would appear appropriate to retain the language of the February directive, or to employ the roughly similar language of alternative B of today's drafts. If, however, the objective was to keep policy unchanged in the sense of maintaining the less firm conditions achieved under the February directive--and not moving to still easier conditions--alternative A would appear to be the preferred directive.

Mr. Brimmer remarked that on that basis he favored alternative A of today's drafts, since he did not want to continue the movement to less firm money market conditions at this time.

Mr. Sherrill observed that he was beginning to believe that the economic outlook was weaker than implied by the GNP projections presented by the staff in the February chart show. It also appeared that the growth rates in the aggregates projected under alternative A of the draft directives were a notch weaker than those the Committee had agreed upon at the previous meeting.

Mr. Sherrill noted that both of those considerations inclined him toward alternative B of the directive drafts. In light of other considerations, however, he favored alternative A today. For one thing, he was still concerned about the risk of a resurgence in inflationary expectations. Secondly, he was worried about the possible consequences of further large declines in market interest rates. Such declines might be interpreted as signifying a larger move in the direction of easing than the Committee intended, and they might lead to an undesirably rapid reintermediation by banks as CD's became increasingly competitive. Much would depend on the use banks made of the time deposit funds they acquired. It would be a healthy development if such funds were employed to improve the banks' liquidity positions. It appeared, however, that loan demand was still strong, and that banks expected it to remain so. If banks used additions to their time deposits to expand their lending significantly they might fuel a resurgence of activity.

It was because of such concerns, Mr. Sherrill continued, that he favored alternative A today. It was quite possible, however, that he would be advocating a further easing of policy in the near future--particularly if the economic information becoming available tended to confirm his fears about the economy.

Mr. Hickman noted that the projections of the adjusted bank credit proxy given in the blue book in connection with alternative A were for growth at annual rates of 8 to 11 per cent in March, 5 to 8 per cent in April, and 5 per cent in the second quarter as a whole. He thought such growth rates were preferable to those projected in connection with alternative B, which were 8 to 11 per cent in both March and April and 7 per cent in the second quarter. He was not sure, however, that he favored the language of alternative A calling for the maintenance of prevailing money market conditions. In particular, he would like to see the three-month bill rate--which had been drifting up recently--held below 7 per cent and permitted to trend down to about the 6-3/4 per cent level. And he hoped the Manager would not undertake to keep the Federal funds rate at 8 per cent or above, but would permit it to drift lower if needed to achieve a 6-3/4 per cent bill rate and appropriate bank credit expansion.

Mr. Hickman expressed the view that monetary policy was now on the proper path and that the Committee should be cautious about making any further changes at this time. It was true that industrial production had fallen considerably over the past six months and that the unemployment rate recently had risen sharply. In his opinion, however, such developments were a necessary part of the process of containing inflation and it was important that the Committee not overreact--as it had at times in the past--by easing too much. He thought the point was near at which industrial production would level out and, hopefully, begin to rise. Two major influences that should be operating to prevent a serious downward spiral in production were the possibility that inventory adjustments in some consumer goods' lines were about completed, and the expectation that consumer income would rise more rapidly over the next few months under the stimulus of retroactive social security payments.

Mr. Eastburn commented that, given the state of the art in the area of financial projections, he would not place a great deal of emphasis on the differences between alternatives A and B. However, along with Mr. Sherrill he thought there were limits to the tolerable side effects of efforts to encourage growth in the monetary aggregates. For that reason he had a marginal preference for alternative A. On the other hand, indications were beginning to emerge of some easing of credit demand. Accordingly, he thought the Manager should be particularly alert to deviations of the aggregates from the projections and should be prepared to react promptly if shortfalls developed.

Mr. Kimbrel said that in general he agreed with the green book's assessment of current economic conditions, although in some respects the economy of the Sixth District had fared slightly better than that of the nation as a whole. From his interpretation of the thinking of his own staff and the Board's, he had two major impressions: first, that inflationary pressures would not be slowed substantially during 1970; and secondly, that there probably would be only a shallow dip in the economy instead of a 10 per cent drop in output and a 7 per cent unemployment rate, as experienced in previous full-fledged post-war recessions.

Since he viewed the risks of a major recession as small, Mr. Kimbrel continued, he would urge the Committee not to ease policy too much. In some postwar recessions, especially the mini-recession of 1966, the Federal Reserve had first reacted cautiously. As the economic statistics worsened, however, the System had become overly concerned and, in retrospect, had eased far too much. It would be unfortunate if the Federal Reserve did not learn from the lessons of history. He thought the Committee had gone far enough in its easing actions, certainly for the time being.

Mr. Kimbrel remarked that all of the Committee members recognized, of course, that the art of predicting monetary aggregates was still far from perfect. Time deposits were particularly unpredictable when relationships between Regulation Q ceilings and short-term market rates changed. He believed, therefore, that it was especially important to try to maintain the currently less firm money market conditions, and to resist any tendencies for growth in money and bank credit to exceed the staff's projections associated with alternative A.

Mr. Lewis said he found himself substantially in agreement with Mr. Partee's appraisal of the economic situation. He would like to see moderate growth in money, and he favored alternative A for the directive.

Mr. Robertson made the following statement:

All things considered, I believe that the current setting of monetary policy is just about right.

We appear to have achieved conditions which have relaxed the most stringent tensions in the financial markets and have set the banking system back on a course of moderate deposit growth. It will take a few more weeks for us to judge precisely how the banking system will react. In the interim, I think we would be well advised to exercise great caution in proceeding further along an easing track. Market interest rates are drawing closer to levels that will permit substantial re-expansion of bank liabilities. The pent-up demand for liquidity is strong, at both banks and nonbanks. This combination of circumstances would easily produce a marked resurgence of bank deposits, akin to what took place in the spring of 1967 and again in the summer and fall of 1968. Reversing such a surge, once it starts, is a difficult business, and the disruption it could cause to the orderly cooling of inflation could be a serious setback to our stabilization goals.

Therefore, we need to be extraordinarily careful today in formulating our policy decision. Having started on a gradual move toward less firm conditions in the money market, I would hesitate to discontinue it before we have seen whether it will bear fruit. Consequently, rather than seeking to maintain the somewhat less firm conditions that have been attained in the money market, as specified in alternative A, I would accept the language of alternative B, but with an admonition to the Manager to move ever so cautiously. Thus, I would not have him move promptly to the money market conditions specified in connection with alternative B in the blue book, but only to move very gradually in their direction.

In addition, I would substitute the proviso clause of alternative A for the one in alternative B, because what I seek for the moment is a "moderate" growth pattern for the monetary aggregates without sharp changes in money market conditions.

I would not be concerned if money market rates eased slightly, but I would be concerned if monetary aggregates increased immoderately, for I am still more worried about losing the battle against inflation than I am about the need to take action now to forestall a

> serious recession. Of course, the aggregates may behave in disparate ways relative to projections. I would be less concerned with a greater than projected expansion of time deposits (especially if that was associated with some repayment of other borrowings) than I would be with shortfalls in the monetary aggregates from a moderate growth pattern.

Mr. Robertson added that he could also support retention of the second paragraph of the directive issued at the previous meeting.

Mr. Maisel asked why different forms of the proviso clause were employed in alternatives A and B.

Mr. Holland replied that the reference in alternative B was to "the anticipated growth pattern" for the aggregates--rather than to a "moderate" growth pattern, as in A--because somewhat higher growth rates were projected under B. If the Committee was prepared to regard the growth rates associated with B as "moderate," proviso clause language like that of alternative A could be used in B.

Mr. Robertson remarked that he preferred the growth rates in the aggregates projected in connection with alternative A. He had expressed a preference for the language of alternative B because he thought the Committee should make it clear that it was prepared to see money market conditions become less firm if that proved necessary to achieve the desired growth rates in the aggregates.

Mr. Hayes noted that under the proviso clause of alternative A the Manager would be instructed to modify operations if the aggregates fell short of the growth rates the staff projected in connection with that alternative.

Mr. Daane said his position was similar to Mr. Robertson's. To his mind alternative A suffered from the disadvantage of suggesting that it was the Committee's intent to hold rigidly to a "no change" policy.

Mr. Maisel said he agreed in principle that the aggregative growth rates desired could be obtained under alternative A. The choice between the two alternatives might nevertheless be significant if the Manager was more likely to implement the proviso clause aggressively under alternative B.

Mr. Swan suggested that the Committee resolve the problem by employing the language Mr. Coldwell had suggested earlier, which called for "accommodating the trend toward somewhat less firm conditions in the money market that has been attained...."

Messrs. Hayes and Brimmer both indicated that they would not favor such language because, like alternative B, it involved an unconditional instruction to seek less firm money market conditions.

Chairman Burns remarked that most members of the Committee had expressed a preference for alternative A, but it appeared that various members were attaching markedly different interpretations to it. At the same time, a great deal of emphasis had been placed on the importance of achieving moderate growth in money and bank credit, and there seemed to be wide agreement that the growth rates projected in connection with A would be appropriate. He also would be prepared to support alternative A if he were confident that those growth rates would be achieved; for example, he would be quite satisfied with the 3 per cent rate of expansion in money projected for the second quarter. On the basis of recent experience, however, he was concerned about the risk of shortfalls, and he would prefer some different language to guard against such a development. Perhaps that purpose could be served by alternative B, or the language Mr. Coldwell had suggested; or by alternative A with the word "somewhat" deleted from the phrase "maintaining the somewhat less firm conditions that have been attained in the money market."

Mr. Mitchell commented that he would prefer alternative A with the word "somewhat" deleted to the other possibilities the Chairman had mentioned. Mr. Hayes expressed a similar view.

In response to the Chairman's request for comment, Mr. Holmes said he would interpret such a directive as indicating that the Committee attached great importance to the attainment of the growth rates for the aggregates associated with alternative A in the blue book. He would propose to operate at the outset on the assumption that the staff was correct in its expectation that such growth rates were consistent with a continuation of the less firm money market conditions that had been attained. It would take some time to determine whether the staff's expectations were, in fact, correct, but if developments led him to the conclusion that they were not he would act promptly and strongly under the proviso clause.

Chairman Burns commented that he was disturbed by Mr. Holmes' implication that there might well be a further delay in moving to achieve the Committee's objectives with respect to the aggregates.

Mr. Mitchell asked whether the failure to achieve the Committee's objectives for the aggregates in February had been a consequence of efforts to act unobtrusively in modifying money market conditions.

Mr. Holmes replied that it was always difficult to explain a particular short-term deviation in an aggregate. He suspected, however, that the February decline in the money supply was a one-month aberration, the mirror image of the unusually large increase of January. It was worth noting that both the money supply and the bank credit proxy turned up in the latter part of February and that the projections for March suggested substantial growth.

In response to a question by Mr. Hickman, Mr. Holmes said that, if the evidence at the end of the first week of the forthcoming interval indicated that the aggregates were falling below their projected growth paths, he would modify operations promptly in the direction of ease.

Mr. Hickman remarked that on that basis he would be prepared to vote for alternative A. He would, however, prefer a directive that was more explicit with respect to the Committee's objectives for the aggregates. Whatever the language, he hoped the Manager would also be prepared to move toward firmer money market conditions if necessary to avoid excessive growth in the aggregates.

Chairman Burns then said that the Committee's best course today might be simply to readopt the language of the February 10 directive calling for a gradual movement toward somewhat less firm money market conditions, on the understanding that the fundamental objective was to achieve the growth rates associated with alternative A in the current blue book. Such a course would be consistent with what he assumed was the Committee's intent for the longer run--of moving gradually toward less firm conditions and not freezing interest rates at current levels, which were extraordinarily high by historical standards.

Mr. Holmes remarked that no doubt there were various formulations for the directive that would serve to communicate the Committee's intentions to the Account Management. He would note, however, that a renewal of the directive issued at the February meeting would imply that the Committee wanted operations to be directed immediately at attaining less firm money market conditions, whether or not the aggregates appeared to be on target. He had thought the Committee would prefer today to maintain the conditions now prevailing so long as the aggregates were not falling short of the projections.

Mr. Hayes concurred in the Manager's comment. With respect to the Chairman's observation about the Committee's longer-run objectives, Mr. Hayes noted that the directive referred specifically to operations "until the next meeting of the Committee."

After further discussion, Mr. Mitchell remarked that the Committee's intent might best be expressed by directive language which placed greater emphasis on the objectives with respect to the aggregates. He proposed a second paragraph reading as follows: "To implement this policy, the Committee desires to see moderate growth in money and bank credit over the months ahead. System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining money market conditions consistent with that objective."

There was general agreement with Mr. Mitchell's proposal.

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

The information reviewed at this meeting suggests that real economic activity, which leveled off in the fourth quarter of 1969, is weakening further in early 1970. Prices and costs, however, are continuing to rise at a rapid pace. Market interest rates have declined considerably in recent weeks, partly as a result of changing investor attitudes regarding the outlook for economic activity and monetary policy. Both bank credit and the money supply declined on average in February, but both were tending upward in the latter part of the month. Outflows of time and savings funds at banks and nonbank thrift institutions, which had been sizable in January, apparently ceased in February, reflecting advances in rates offered on such funds following the recent increases in regulatory ceilings, together with declines in short-term market interest rates. The U.S. foreign trade surplus narrowed in January and the over-all balance of payments deficit has remained large in recent weeks. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, the Committee desires to see moderate growth in money and bank credit over the months ahead. System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining money market conditions consistent with that objective.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, April 7, 1970, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

CONFIDENTIAL (FR) March 9, 1970

Drafts of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on March 10, 1970

FIRST PARAGRAPH

The information reviewed at this meeting suggests that real economic activity, which leveled off in the fourth quarter of 1969, is weakening further in early 1970. Prices and costs, however, are continuing to rise at a rapid pace. Market interest rates have declined considerably in recent weeks, partly as a result of changing investor attitudes regarding the outlook for economic activity and monetary policy. Both bank credit and the money supply declined on average in February, but both were tending upward in the latter part of the month. Outflows of time and savings funds at banks and nonbank thrift institutions, which had been sizable in January, apparently ceased in February, reflecting advances in rates offered on such funds following the recent increases in regulatory ceilings, together with declines in short-term market interest rates. The U.S. foreign trade surplus narrowed in January and the over-all balance of payments deficit has remained large in recent weeks. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.

SECOND PARAGRAPH

Alternative A

To implement this policy, while taking account of the Committee's desire to see moderate growth in money and bank credit over the months ahead, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the somewhat less firm conditions that have been attained in the money market; provided, however, that operations shall be modified promptly to resist any tendency for money and bank credit to deviate significantly from a moderate growth pattern.

Alternative B

To implement this policy, while taking account of the Committee's desire to see moderate growth in money and bank credit over the months ahead, System open market operations until the next meeting of the Committee shall be conducted with a view to continuing to move gradually toward less firm conditions in the money market; provided, however, that operations shall be modified promptly to resist any tendency for money and bank credit to deviate significantly from the anticipated growth pattern.