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, November 25, 1969, at 9:30 a.m.

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

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

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

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

Mr. Cardon, Assistant to the Board of Governors
Messrs. Coyne and Nichols, Special Assistants to the Board of Governors

Mr. O'Connell, Deputy General Counsel, Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Messrs. Keir and Wernick, Associate Advisers, Division of Research and Statistics, Board of Governors
Mr. Bernard, Special Assistant, Office of the Secretary, Board of Governors
Mr. Baker, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, Open Market Secretariat Assistant, Office of the Secretary, Board of Governors

Messrs. Eisenmenger, Taylor, and Craven, Senior Vice Presidents of the Federal Reserve Banks of Boston, Atlanta, and San Francisco, respectively
Messrs. Hocter and Snellings, Vice Presidents of the Federal Reserve Banks of Cleveland and Richmond, respectively
Mr Kareken, Economic Adviser, Federal Reserve Bank of Minneapolis
Mr. Keran, Assistant Vice President, Federal Reserve Bank of St. Louis
Mr. Cooper, Manager, Securities and Acceptance Departments, Federal Reserve Bank of New York

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on October 28, 1969, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee held on October 28, 1969, was accepted.

By unanimous vote, the action of Committee members amending paragraph 1(a) of the continuing authority directive, effective November 14, 1969, to increase the leeway for changes in System Account holdings of U.S. Government securities between meetings of the Committee from $2 billion to $3 billion, was ratified.

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 October 28 through November 19, 1969, and a supplemental report covering the period November 20 through 24, 1969. Copies of these reports have been placed in the files of the Committee.

Mr. Coombs said that he would supplement the written reports this morning with only brief comments on market conditions in order to provide time for discussion of two major policy problems that had arisen in connection with the swap network. The Treasury gold stock remained unchanged and the Stabilization Fund still had about $800 million of gold on hand, with some possibility that the Germans might have to sell a sizable amount of gold to the Treasury over the next month or so. On the free gold market, there was very good news indeed; the London price had plummeted from a level of $40.00 at the time of the last Committee meeting to $35.35 at the first fixing this morning. It had edged up to $35.45 at the second fixing, but it was not impossible that it would drop to $35.00 some time soon.

To some extent, Mr. Coombs continued, the abrupt decline of the gold price reflected relief from earlier fears of currency instability, now that the devaluation of the French franc and the revaluation of the German mark were out of the way A reported

breakup of the Swiss marketing syndicate that had been propping up the price in earlier months and some dishoarding had also been contributing factors. The basic cause, however, seemed to have been a shift by the South Africans into a heavy payments deficit--which was forcing them to try to market practically all of their output--together with a drying up of both industrial and speculative demands as buyers waited for the price to bottom out.

The gold price decline had been a very helpful and encouraging development, Mr Coombs remarked. However, he thought it would be unwise to assume that that was the end of the story. In due course, the South African balance of payments probably would shift back into balance and then perhaps into surplus. That would have an immediate effect on the market, since the supply would be cut while industrial demand for gold would probably continue to grow. Meanwhile, the thorny problem of whether South Africa would be allowed to sell gold to the International Monetary Fund or to central banks whenever the market price dropped to $35.00 was apparently still unresolved.

On the exchange markets, Mr. Coombs observed, heavy outflows from Germany had continued with the German Federal Bank experiencing net reserve losses of $3.7 billion since the previous parity was abandoned late in September Despite those losses German reserves currently stood at $8.7 billion, compared with the level of $8.9 billion reached in the summer of 1968 before speculation got under

way. The Federal Bank's holdings of liquid assets in the form of Treasury bills had been severely depleted and the Germans would be drawing $540 million on their super gold tranche with the International Monetary Fund tomorrow. They might even have recourse to the Federal Reserve swap line on a relatively short-term basis if further heavy outflows occurred. The German drawing on the IMF would have the useful consequence of enabling the Account Management to pick up some Belgian francs--perhaps enough to pay off the $25 million drawing the System would be making on the National Bank of Belgium tomorrow--as well as some guilders for paying down the outstanding debt on the swap line with the Netherlands Bank.

Most of the other continental currencies were holding more or less even, Mr Coombs said. The reversal of earlier speculation on the mark was currently offsetting underlying pressures on both the French franc and Italian lira, and presumably was also contributing to the improved tone of sterling. Sizable dollar gains by the Bank of England earlier this month had tapered off considerably, but that might mainly reflect the adverse seasonal factors at this time of the year He remained hopeful that after the turn of the year the normal seasonal strengthening of sterling would enable the Bank of England to resume accumulating dollars on a sizable scale. The only small cloud in the picture at the moment was the recurring rumor of a possible revaluation of the Swiss franc. So far those rumors had not

had much effect on the flows of funds, but if they continued they could produce problems.

During the past year, Mr. Coombs noted, drawings on the swap network by the Federal Reserve and eight foreign banks had amounted to more than $3 billion--far above the volume of any earlier year. In the same period total gold transactions by the U.S. Treasury--both purchases and sales--were $700 million; and drawings of new money from the Fund--that is, omitting British drawings for the purpose of rolling over outstanding debt--came to $900 million. From those figures it seemed clear that the System's swap network was now functioning as the major settlements mechanism in the international financial system.

> By unanimous vote, the System open market transactions in foreign currencies during the period October 28 through November 24, 1969, were approved, ratified, and confirmed.

Mr. Coombs then said he would comment on the first of the two important policy questions that had arisen and on which he sought guidance from the Committee. As the members knew, paragraph 1.D. of the authorization for System foreign currency operations provided that swap drawings "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." A very high percentage--well over 90 per cent--of the $20.4 billion of swap transactions undertaken since the Federal

Reserve began operations in 1962 had been liquidated in less than a year's time, most within six months. In fact, the only instance in which swap drawings had run appreciably beyond the one-year limit was under the Bank of England line, which now had been in continuous use for over 16 months. In earlier years, when British drawings on the swap line had threatened to run on too long, various special transactions had been arranged to clean up the line. In November 1964 and in May 1965, that was accomplished by large British drawings on the IMF; in February 1966, outstanding British swap debt was fully liquidated with the proceeds of the sale of the British Government's securities portfolio; and in June 1968, the line was cleared up through a combination of a British drawing on the IMF and purchases by the Treasury as well as by the System of guaranteed sterling. In all of those instances the Bank of England had urged upon the British Government the necessity of such cleanups of the swap line; and the System had had the support of the U.S. Treasury, which in June 1968 actually took over some of the British debt to the System by purchasing guaranteed sterling. In none of those instances was there opposition to the clearing up of overdue Bank of England debt to the Federal Reserve from the continental central banks which also were creditors to the British. Those central banks conceded to the System a priority in debt repayments, recognizing that the System was carrying a disproportionate share of international credits to the British and that the System's credit line to the Bank of England was renewable while

the continental credit lines generally were not. On the first of those grounds, he thought the case for priority in repayment was as strong or stronger now than at earlier times. As indicated in one of the two tables he had had distributed today[1/] the United States currently accounted for nearly 71 per cent of outstanding credits to the Bank of England, excluding overnight credits and credit under the First Group Arrangement.

Mr. Coombs commented that since October 1968 there had been an alternating pattern of heavy British drawings and repayments on the Federal Reserve line, resulting in a net increase from $400 million to $775 million in Bank of England debt to the System. At the last Committee meeting, Mr Bodner had indicated that it was planned to continue the policy of pressing the British for repayments whenever the opportunity appeared, and Mr Hayes had reported that President Blessing was sympathetic to his suggestion that the Germans should not seek an undue proportion of British repayments. At that time it had seemed that continuing dollar gains by the Bank of England, with a seasonal strengthening likely after the turn of the year, would permit further major payoffs on the British swap debt. Moreover, it had appeared that if the British could be induced to employ part of their January 1970 allocation of $400-odd million of Special Drawing Rights for swap debt repayments, it might well prove possible to

1/ Copies of these tables, which were captioned "Bank of England debt as of November 21, 1969" and "Schedule of British debt repayments," have been placed in the files of the Committee.

clean up the swap line entirely by say, the end of January or early February 1970.

After their last swap repayment to the System on November 7, 1969, Mr Coombs observed, the Bank of England had a cash balance of $350 million which he had hoped would be employed in due course to make partial payment against swap maturities amounting to $625 million between November 10 and 20. However, the Bank of England instead requested renewals of all of those swap maturities while simultaneously informing him that they intended to make the following repayments totaling $418 million against other debt: on the December instalment of the First Group Arrangement (sterling balances) $114 million; on the German recycling credit, $125 million; and on the year-end instalment on the U.S.-Canadian loan of 1946, $179 million. He had asked the Bank of England whether it would be possible to work out some deferral of the December instalment on the First Group Arrangement, such as had been effected in September when the Bank of England borrowed $75 million from the Bank for International Settlements in order to settle the continental banks' claims while the Treasury and the Federal Reserve postponed the instalment due them. The Bank of England had replied that they now felt that they should give priority to the First Group Arrangement debt. He had then contacted the U.S. Treasury, which did not seem inclined to support his suggestion for a postponement of the instalment. On November 13 the Bank of England proceeded to prepay the instalment

of $114 million, which was not due until December 15. Of that repayment, the Federal Reserve share was $19.5 million in the form of liquidation of guaranteed sterling holdings.

Regarding the proposed prepayment of the $125 million due under the $250 million German recycling credit, Mr. Coombs said he had reminded the Bank of England of the assurances previously received by Mr. Hayes from President Blessing that the Germans would not press for such priority over the Federal Reserve. He had also sought support from the U.S. Treasury for an arrangement which would give the Federal Reserve at least equal priority with the Germans in getting such repayments as the British were able to make. Mr. Daane had brought to the Basle meeting the Treasury's view that the Federal Reserve should yield priority to the Germans The Treasury had taken that position despite the fact that in no previous discussion of recycling arrangements had any suggestion ever been made that such credit should have priority over debt to the Federal Reserve. In light of the Treasury's position there was no alternative but to concede British repayment of the remaining $125 million owing under the German recycling credit.

Finally, Mr. Coombs continued, the Bank of England had indicated that they did not plan to request a deferment, as they had last year, of the interest and principal of $179 million due to the United States and Canadian Governments under the 1946 loan arrangements Here again, the U.S. Treasury had supported the

British Government's intention to make that repayment. As a result of those three decisions, $418 million had been diverted to other creditors which might otherwise have been used, at least in part, to pay down overdue debt to the System.

Mr Coombs remarked that there had been another development at the Basle meeting which he had found even more disappointing. In a conversation among Messrs. Daane, Hayes, Governor O'Brien, and himself. Governor O'Brien had indicated that the present British thinking was to use the $400 million of SDR's to be issued to the British Government in January for the purpose of liquidating an equivalent amount of the overnight credits--which totaled $550 million--that the U.S. Treasury had been extending to the Bank of England at the end of each month. In summary, therefore, as shown on the second of the tables distributed, the Bank of England had devoted and was planning to devote a total of roughly $800 million of dollar balances and SDR's to repayment of debt to the continental central banks and to the U.S. Treasury, while simultaneously repaying $19.5 million of guaranteed sterling held by the Federal Reserve

As he had mentioned, Mr. Coombs said, the Bank of England repayments under the First Group Arrangement and of the German recycling credit had already been executed and there was nothing that could be done about them now. The year-end payment of $179 million to the United States and Canadian Governments could conceivably be postponed in favor of debt repayments to the Federal

Reserve, but he was doubtful that either the Treasury or the British Government would agree. In that case there was at least the consolation that a very large part of the year-end repayment would be made to an agency of the United States

Mr. Coombs thought the main issue before the Committee was whether to reiterate and press the claim of priority in future debt repayments from, first the prospective dollar gains by the Bank of England over the coming months, and, secondly, the prospective allocation to the British Government of $400 million in SDR's. At Basle Messrs. Daane and Hayes and he had urged Governor O'Brien to give the Federal Reserve priority on current receipts. Apparently that discussion--as well as the timing of today's meeting of the Committee--had had some effect; he had just learned that the Bank of England planned to repay $75 million of outstanding drawings this week. The plan to use SDR's to repay overnight credits from the U.S. Treasury evidently had originated in Britain. It was his impression that the Treasury had not urged that course and was quite prepared to have gradual repayments at a rate of perhaps $25 million per month. If the Committee were to reassert forcefully the policy approach so far pursued, he thought there would be a fair chance of cleaning up British debt to the Federal Reserve by March or April of next year On the other hand, if it were to retreat from the earlier policy there was a major risk that the System would continually be called upon to renew outstanding credits to the British, while remaining

exposed to possibly heavy new drawings on the swap line by the Bank of England as the British election approached.

Chairman Martin observed that the two tables Mr Coombs had distributed should be treated as highly confidential

The Chairman then invited Messrs. Daane and Hayes to comment on the Basle meeting.

Mr Daane remarked that he might begin with a few words on the subject of British debt repayments to Germany. Mr. Coombs had noted that Dr. Blessing earlier had given assurances to Mr. Hayes that the Germans would not press for prepayment of the remainder of the recycling credit. In the discussions at Basle, however, it was evident that Dr Blessing had become increasingly concerned about Germany's liquidity problem. While his attitude remained cooperative, he clearly indicated interest in having the recycling credit cleared up. The British were also definitely interested in repaying that credit quickly, in order to increase the likelihood that recycling credits would be available in the future from Germany, or others, if a need for them arose. That consideration also had been uppermost in the thinking at the U.S. Treasury. He personally did not think any important purpose would have been served by further pressing the British to defer part of their repayment to the Germans; at best, some of the $75 million they would be repaying to the System this week would have been received a little earlier.

As to the Basle meeting itself, Mr. Daane continued, the atmosphere was quiet largely because of the continuing euphoria following the German revaluation and the improvement in Britain's payments position. During much of the Sunday afternoon session and all of the evening meeting the focus was on the U.S. situation. There were two main threads to the discussion--considerable skepticism that the United States would win its battle against inflation, and worry about the deterioration in the U.S. balance of payments To illustrate, during the afternoon session President Stopper of the Swiss National Bank expressed the hope that the mark revaluation would constitute a lasting contribution to international stability, but indicated that he would expect that outcome "only if our American friends put things in order." And Governor O'Brien said his chief worry in the external area was about the ability of the United States to control its inflation and about the resulting implications for interest rates. In the evening meeting Governor Ansiaux of the Belgian National Bank, among others, argued that the United States was exporting inflation and forcing European countries to the point at which they would have to revalue. The Governor thought there was no evidence that the U.S. efforts to control inflation were taking hold. Both Mr Hayes and he (Mr. Daane) had tried to make the opposite case. In the afternoon Mr Hayes gave a scholarly and--to Mr Daane's mind--persuasive account of the progress that had been made, largely reflecting U.S. monetary policy, and emphasized the

degree of restraint in effect In the evening he (Mr Daane) also tried to make clear that the Federal Reserve was persevering in its efforts.

Mr Daane said he would comment on only a few other highlights of the meeting. In summarizing developments since the mark revaluation Dr. Blessing placed great stress on Germany's reserve losses and resulting liquidity problem, leading to the current drawing of their super gold tranche in the IMF. He said that Germany was still fighting a boom but that he expected domestic inflation to be ended and stability restored by the middle of next year Dr. Blessing gave two reasons for the decision to revalue the mark by 9.3 per cent, more than had been expected. One purpose was to prevent a new wave of speculation on a possible further revaluation, and the second was to exert heavy pressure on domestic prices and costs. The German revaluation was generally viewed as a constructive measure, except by President Stopper who thought the amount of revaluation was unnecessarily high. Dr Stopper also said that the manner in which it had been handled--including all of the public discussion--had made it very difficult for the Swiss to follow suit

Mr. Daane observed that Governor O'Brien's comments were for the most part cheerful He noted that Britain had been able to repay the substantial sum of $1.5 billion on outstanding debt, and that he expected a surplus in the neighborhood of $750 million

in the U.K. current account in 1969. However, the Governor did express some apprehension about domestic wage pressures Governor Wormser of the Bank of France was fairly optimistic about the French situation. He mentioned the favorable psychological effects of the German revaluation and expressed the view that the French economic program would produce the necessary results in a reasonably short period.

Another matter discussed, Mr Daane continued, was the possibility of a meeting of experts in Basle on the question of greater exchange rate flexibility It was agreed that the experts should meet primarily to consider the technical aspects of proposals for wider bands, as a preliminary to discussions in the IMF. The experts would include exchange technicians and policy officials such as some Deputies of the Group of Ten. Finally, Dr Zijlstra had asked him (Mr Daane) to report on the status of the U.S. negotiations with South Africa regarding gold, and he had reported that those negotiations remained stalemated

Mr Hayes said he would add only a few comments regarding the discussion at Basle. With respect to the contemplated January discussion of exchange rate flexibility, the plan was to consider the technical aspects of the subject more or less on a one-time basis, and not to embark on a continuing study such as was being undertaken by the IMF As to the tenor of the meeting in general, Mr. Daane had already noted the degree of concentration on the U.S.

situation and the comments that the United States was exporting inflation and forcing revaluations. In the course of the discussion Dr Blessing had raised a question about the outlook for the U.S. balance of payments on the official settlements basis, especially at the time when U.S. monetary policy shifted toward ease. The problem that would arise then was, of course, already well appreciated here.

Turning to the subject of British debt repayment, Mr. Hayes said he personally had been quite troubled by the idea of giving priority to the German recycling credits. The argument that the British and the U.S. Treasury had found persuasive--that repayments to the Germans were desirable to insure the availability of further credits if needed--seemed to him to involve an assumption that the Federal Reserve was an easy source of funds To his mind, the System had fully as strong a claim on the British as the German Federal Bank. Both, in effect, had engaged in recycling, and the only difference was that the System had given credits sooner and in much larger volume.

More broadly, Mr. Hayes said, he was troubled by the role played in the matter by the U.S. Treasury. From the beginning of System foreign currency operations in 1962 it had been the Committee's position that it had responsibility for making the basic judgments regarding Federal Reserve credit operations. It had been recognized, of course, that the System would not engage

in operations that would bring it into conflict with the Treasury's posture. But the Treasury's responsibility for providing necessary guidance had not been thought to extend to the point of requiring the System to grant credit in any particular situation. There was only a thin line between requiring the System to extend credit and taking the position that a System debtor should give priority to repayments to other creditors.

Chairman Martin commented that the problem that had arisen in connection with British debt repayments was an important one, on which the Special Manager needed to have guidance from the Committee. Personally, he thought the line along which Mr Coombs had been working was appropriate It would be highly undesirable for the System to put itself in the position of being an assured source of credit to anyone. It was encouraging that the British would be repaying $75 million to the System this week.

Mr. Robertson concurred in the Chairman's observation.

Mr. Mitchell referred to the British plan to apply its $400 million SDR allocation to repaying overnight credits from the U.S. Treasury, and expressed the view that the System should press to have as much of that sum as possible applied instead to repayment of debt to the Federal Reserve.

Mr. Hickman concurred in Mr Mitchell's view. He added that a failure of the British to pay off their debt to the Federal Reserve as rapidly as possible might well undermine the System's whole swap network.

Mr. Coombs said he also thought that if the British were prepared to use their SDR allocation to repay debt to the U.S. the payment should be to the System rather than to the Treasury. The System's claim was far stronger, and the Treasury's overnight credit extensions were essentially risk-free. Moreover, if the British were thinking in terms of giving priority to overnight credits, they might well decide to apply their SDR allocation to partial repayments of such credits to both the U.S. Treasury and the BIS.

Mr. Coombs added that the window-dressing aspects of the U.S. Treasury's overnight credits to the British obviously were distasteful to both parties. However, as he had indicated earlier, the plan to apply Britain's SDR allocation to their repayment had originated in Britain, and the Treasury apparently would be agreeable to having them paid off at a rate of $25 million a month. Accordingly, he was hopeful that the Treasury would not object to the System's pressing the British to apply their SDR's to repayment of debt under the swap line.

Mr. Daane remarked that while he would not necessarily object to such a course he thought there was some question as to whether that would be an appropriate use of SDR's if they were actually all to be used in repayment.

Mr. Coombs noted that the IMF had indicated that it would be appropriate to use SDR's to repay debt to the Fund. If that were the case he thought it would clearly be proper to use them to repay shorter-term credits, such as those under the swap line.

Mr. Brimmer said he would like to align himself with the position taken by Mr. Mitchell At the same time, he would remind the Committee that in the summer of 1968, when the second sterling credit balance arrangement was under discussion, some of the members had taken the view that it would be appropriate for the Treasury to seek a Congressional appropriation to finance credits to the British rather than relying on the Federal Reserve. It was noted, however, that that was not an appropriate time for such action in view of the prospective change in the Administration, and the question was put aside. He thought the time had now arrived for a systematic discussion of the whole problem with the Treasury. Perhaps the Chairman could raise the matter with Secretary Kennedy.

Mr Solomon referred to the earlier comments on the question of whether it would be appropriate for the British to use their SDR's for repayment of debt to the System. He noted that the Fund's Articles of Agreement provided that SDR's might be used to repay debt to the IMF and to meet current balance of payments needs, including repayment of other debt Nevertheless, he questioned whether it would be desirable to press another country to pay over to the United States its entire allocation of SDR's in the very month they were first allocated. He recalled that Chairman Martin had referred to SDR's as "fragile flowers" which should be permitted to grow. It was important to avoid creating the impression that U.S. officials

viewed SDR's as a mechanism that had been created primarily for benefit of the United States. If the British themselves had decided to use their SDR's to repay debt to the United States he would agree with Mr. Coombs that it would be appropriate for the Federal Reserve to press its claim against that of the U.S Treasury. In his judgment, however, it would be unfortunate if the System pressed its claim against other possible uses of Britain's SDR's.

Mr. Daane said he thought Mr. Solomon's point was well taken, particularly since part of the general concern abroad about the outlook for the U.S. balance of payments was the particular concern that the United States would finance continuing deficits with SDR's. He would note, however, that the System's representatives at Basle had raised with Governor O'Brien the question of why the British thought they should give priority to repayment of the Treasury's overnight credits.

Chairman Martin remarked that there was no question that SDR's had to be nurtured as fragile flowers. He thought the discussion today would provide the Special Manager with the guidance he needed in the matter. In addition, there would be an opportunity next week to discuss the subject with Governor O'Brien, who was planning to visit the United States then.

The Chairman then asked the Special Manager to comment on the second of the two problems of policy the latter had referred to earlier.

Mr Coombs noted that at its previous meeting the Committee had approved renewals of all of its standby swap arrangements for further periods of one year. In accordance with that action, the Account Management had been sending telexes to the various swap network partners proposing such renewals, and a number of affirmative replies had already been received. The problem arose in connection with the response received last Friday from the National Bank of Switzerland, which read as follows: "We agree in principle to renewal of reciprocal U.S. dollar-Swiss franc swap arrangement for one year to December 2, 1970. We understand that some European central banks intend to discuss in December the revaluation clause of swap arrangements. We assume that the same conditions as granted to other central banks would apply to our swap arrangement."

Mr. Coombs remarked that the reference in the message to "some European central banks" probably referred to the Common Market group, which presumably was holding some sort of a meeting to discuss renewal of their swap lines with the Federal Reserve. The revaluation clause referred to was, of course, the safeguard in all of the Federal Reserve's swap agreements which protected it against loss if it had swap debt outstanding in a currency that was revalued. In the agreement with the Swiss National Bank, for example, the clause read in part as follows: "To protect both parties against the remote risk of a revaluation of the other's currency, we suggest the following

procedure: We place with you a standing order to be executed when necessary for that purpose to purchase for our account Swiss francs against dollars in an amount sufficient to replenish any earlier drafts upon our Swiss franc balances created by the swap." The next sentence began "We shall accept from you a similar standing order to be executed when necessary. ." and concluded with language paralleling that of the preceding sentence.

In effect, Mr. Coombs continued, if one party had liabilities outstanding in the other's currency and that currency was about to be revalued, the other party was obligated to execute the standing order before revaluation, thus protecting the debtor against loss on revaluation. That procedure had been worked out because it had proved legally impossible to incorporate formal exchange rate guarantees in the swap agreements.

Mr. Coombs said he had not as yet discussed the matter with any of the central banks in the Common Market countries because he thought he should have the benefit of the Committee's views In the past there had not been much opposition to the revaluation clauses among the System's European partners--indeed, they had welcomed the clause as an effective means of overcoming the legal problems associated with formal guarantees--and he was not entirely sure why the question was arising at this time. He suspected, however, that a number of European central banks had received the impression in recent months that U.S. international financial policy

was now seeking to promote a general revaluation of European currencies to correct an over-valuation of the dollar. Some of the governors of European central banks might feel that the revaluation clauses in the Federal Reserve swap arrangement tended to facilitate, if not actually to encourage, such a U.S. policy approach by freeing the United States of any risk of loss from such revaluation. Or perhaps they objected to the lack of symmetry in the clause--specifically, to the fact that a party with outstanding swap debt at a time it devalues its currency would owe proportionately more in terms of its own currency.

Mr. Coombs said his personal inclination would be to reject such arguments firmly. He would take the position that in negotiating swap agreements the Federal Reserve had simply tried to be helpful in simultaneously accommodating the desire of the U.S. Treasury to minimize gold sales and that of the foreign central banks to have excess dollar holdings guaranteed in terms of their own currencies. However, the Europeans might face policy problems that led them to be equally firm in resisting the revaluation clause. In that case, a possible procedure would be to agree to the deletion of the clause from the standby swap agreement, while notifying the other parties that the System would refuse to draw on the lines to absorb their dollar acquisitions unless there was some sort of equivalent understanding in connection with each individual drawing. To abandon the protection against revaluation

entirely would be to expose the Federal Reserve to a risk of loss which in his judgment it should not accept. If the System refused to make a drawing in some particular case because of the lack of such protection, the problem of what should be done about dollar acquisitions of foreign central banks would be left for that bank and the U.S. Treasury to resolve.

In reply to a question by Mr. Daane, Mr. Coombs said the U.S. Treasury had protection against revaluations of foreign currencies in connection with both its swap drawings and Roosa bonds. He was not sure what the Treasury's position would be on the specific matter at hand. More generally, however, the Treasury's current stance seemed to be that foreign countries acquiring dollars should be prepared to hold larger amounts than in the past on an uncovered basis. That represented a shift in the Treasury's view. It would seem appropriate to him for the Federal Reserve to avoid participation in the discussions of that question.

Mr. Daane said he would fully support Mr Coombs' position on the matter of the revaluation clause. It seemed to him that any opposition to that clause did stem from the feeling on the part of one or two of the Common Market countries that the U.S. was exporting inflation and forcing revaluations, and he thought that if the System agreed to delete the clause it would be tacitly endorsing that view. He would favor strong resistance to any proposals for deleting the clause. It was important to make clear that the object of U.S.

policy was not to force revaluations abroad but simply to get domestic inflation under control

The Chairman then said that if there were no objections the Special Manager would be authorized to proceed on that basis. No objections were raised.

Chairman Martin then noted that Mr Brimmer had attended a meeting of the Economic Policy Committee of the OECD in Paris on November 18 and 19. He invited Mr. Brimmer to report on that meeting and also to bring the Committee up to date on the status of the voluntary foreign credit restraint program.

Mr Brimmer commented that the attitudes prevailing at the BIS meeting in Basle, as described by Messrs. Daane and Hayes, were also in evidence at the EPC meeting. That was no accident, since a number of the participants in the Basle discussions were also present at the Paris meeting.

Following its new format, Mr Brimmer continued, the EPC focused on general questions, including demand management and price inflation in leading countries of the OECD, with particular reference to the United States, Germany, and Japan. Documentation prepared by the Secretariat called for anti-inflationary policies to come into fruition in the first half of 1970. According to the Secretariat's projections for the United States, there would be virtually no growth in real output in the first half of next year, but a sharp turn-around in the second half to an increase at an annual rate of

4 per cent. There was general agreement that the policies now in train in the United States would produce slowing in the first half, although some, including the Swiss and German representatives, thought the risk was on the side of insufficient slowing. At the other end of the spectrum, the British, Norwegian, and Swedish representatives thought the main risk was of a recession in the United States. They believed it would be unwise to maintain current policies until it was clear that the rate of price advance had slowed. The U.S representatives voiced confidence that it would be possible to achieve moderation in real growth in the first half of 1970. The American delegation was divided in its reactions to the projections for the second half of 1970--he personally thought they were unrealistic--but at the suggestion of Mr. McCracken the delegation did not focus on those projections. On the question of whether the posture of monetary policy should be changed now, he (Mr. Brimmer) had expressed the view that the Federal Reserve was prepared to play its role in containing inflation. He had indicated that he saw no basis for an early shift in monetary policy, given the current strength of the economy and the widespread skepticism regarding the System's determination.

Mr. Brimmer went on to say that the Secretariat's documentation had suggested that governments should supplement monetary and fiscal policies with an incomes policy. The discussion of that subject was schizophrenic On the one hand, it was argued that the

effectiveness of incomes policies had never been tested; on the other hand, the United States was urged to reinstate wage-price guidelines or some other kind of incomes policy. Mr McCracken was not willing to agree that an incomes policy was appropriate for the United States. He argued that the proper supplements to monetary and fiscal policies would vary among countries, depending on the circumstances and institutional arrangements in each.

There was some concern, Mr. Brimmer observed, that the United States would in fact bring about a substantial slowing in its economy and at the same time accomplish very little with respect to its balance of payments. That concern was expressed particularly by representatives of the Common Market countries, and it was voiced in the corridors as well as during the formal sessions. Some were fully prepared to argue that the United States should impose greater restraint and maintain it for a longer period in order to have a significant impact on the balance of payments. There was a great deal of conversation about a press report alleging that the U.S. delegation at Basle had said this country was prepared to fight inflation but not to the extent of generating urban riots.

In the discussion of Germany, Mr. Brimmer continued, there was some concern that the slowdown projected for the second half of 1970 might be greater than desirable. The underlying fear was that the conjuncture of severe restraint in a number of countries might lead to a generalized recession. The Germans argued that their

objective was only to return their economy to a normal growth path. He was disturbed to learn that the German authorities planned to hold discussions with their commercial banks about limiting the latter's access to the Euro-bond market. Such action would have implications for the ability of U.S. corporations to float new issues abroad and to refinance outstanding issues which would mature next year. Thus, the German move might contribute to further deterioration of the capital account of the U.S. payments balance.

The only other country discussed at length was Japan, Mr. Brimmer said. As a result of its strong balance of payments position, particularly on current account, Japan had now emerged as a major source of instability in the international financial system. The Japanese were urged to dismantle their remaining import restrictions or to make unilateral tariff reductions.

In the discussion of capital flows, Mr. Brimmer remarked, it was clear that some of the Europeans thought the Federal Reserve had acted unreasonably in imposing marginal reserve requirements on Euro-dollar borrowings of U.S. banks. They objected particularly to the provision of an incentive for banks to hold on to current borrowings. In their judgment it had been improper for the System to permit American banks to pull in Euro-dollars, and it was equally improper to restrict the return flow. On the other hand, some Europeans were concerned about the possible consequences for their economies--or about the difficulties of holding large amounts of unwanted dollars--if a return flow should develop in volume.

Mr. Brimmer then observed that at the previous meeting of the Committee he had described the proposed revisions in the Federal Reserve's voluntary foreign credit restraint program and in the Commerce Department's program for controlling foreign direct investment. As the members would recall, he had taken a rather pessimistic view about the latter, because of his strong feeling that the Department sought a greater degree of liberalization than he considered appropriate. In the interim since that meeting, the situation with respect to both programs had changed. The Treasury had objected to the amount of liberalization sought by Commerce on the grounds that it would lead to excessive capital outflows. As a result Commerce had been asked by the White House to reconsider its original proposals; it was suggested either that the schedules dividing foreign areas into developing, developed, and intermediate countries be eliminated, that the minimum allowables be increased, or that the proportion of retained earnings permitted be raised--but not all three. He assumed that a decision would be reached some time this week on a package with less liberalization than Commerce had originally proposed.

With respect to the VFCR, Mr. Brimmer continued, there had been strenuous objections from within the Government to the Federal Reserve proposal. As the Committee would recall, that proposal was to establish a "General Ceiling" at 90 per cent of the old lending ceiling and a new "Export Term-Loan Ceiling" equal to 1 per cent of each participating bank's total assets at the end of 1968. To meet the objections the

General Ceiling was raised to 100 per cent of the old ceiling. At the same time, the Export Term-Loan Ceiling was reduced to 1/2 per cent of end-of-1968 assets. The other main modification was to retain the exemption for loans made or guaranteed by the Export-Import Bank, guaranteed by the Department of Defense, or insured by the Foreign Credit Insurance Association. Under the previous proposal, new loans in those categories would no longer have been exempt. Under the earlier proposal the potential outflow in 1970 would have been equal to the net increase in the ceiling plus the existing leeway, or about $2-1/2 billion. Under the new proposal the potential outflow would be about $2-1/3 billion plus any increase in the exempted credits.

Mr Hayes remarked that he might say a word about the press report Mr. Brimmer had mentioned to the effect that the U.S. delegation at Basle had said that the risk of urban riots was a constraint on U.S. economic policy. No such statement had been made, of course, and no member of the U.S. delegation had talked with the reporter who wrote the article. The latter subsequently indicated that he got the story from a foreign participant in the Basle meeting. The episode pointed up the wisdom of the rule that participants in those meetings should not discuss the proceedings with reporters.

Chairman Martin commented it was rather naive to assume that there was any direct relation between urban riots and monetary policy.

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 October 28 through November 19, 1969, and a supplemental report covering the period November 20 through 24, 1969. Copies of both reports have been placed in the files of the Committee.

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

> Market psychology deteriorated sharply in the period since the Committee last met, reflecting growing disillusion about any near-term hope of success on either the inflation front or in Vietnam and a mounting concern about a premature ending of fiscal restraint. All in all, market participants concluded that they were in for an extended period of monetary restraint and abandoned the hope that a marked slowdown in the economy would permit some relaxation in Federal Reserve policy around the turn of the year. And the Board's proposed ruling with respect to bank-related commercial paper was generally regarded--particularly by those banks with paper outstanding--as an indication of the System's intention to pursue a policy of relentless pressure on the banking system.
>
> In this atmosphere yields on long-term Government, corporate, and municipal bonds--which had already begun to rise at the time of the last Committee meeting following the spirited October rally in the bond markets--rose sharply to new highs. Underwriters of corporate and municipal bonds have suffered substantial capital losses as syndicates have had to be terminated and unsold bonds disposed of at losses--in some cases of two full points or more. Given the progressive undermining of the capital markets by inflationary expectations, there is growing concern about the capacity of the market to underwrite and distribute the continued heavy volume of corporate, municipal, and agency issues that are expected to come to market in the period ahead. Certainly, further evidence of a slowing of the economy and of fiscal responsibility is a prerequisite for the continued adequate

functioning of these markets. So far, the markets have been able to produce the requisite flow of funds at successively higher interest rates. Some signs were evident late last week that a trading range of rates had again been established, but a sense of apprehension remains prevalent. The market has been anticipating, with considerable concern, that the Federal National Mortgage Association and the Federal Home Loan Banks would again be raising $1 billion or so in December to help support the mortgage market. It now appears that a lesser amount is in store, and as the market learns this there may be a feeling of temporary respite. Agency financing remains a problem for the foreseeable future, however, particularly as the higher general level of interest rates can only exert still greater pressure on the deposits of the thrift institutions and the commercial banks.

Short-term interest rates--which had for some time been fluctuating within a narrow range--also moved sharply higher, particularly last week, to new record highs. The Treasury bill market came under special pressure; dealer portfolios were undesirably high and the market had to absorb bill sales of $2-1/4 billion by the German Federal Bank, the sale last Friday of $2-1/2 billion in tax-anticipation bills by the Treasury, and regular weekly and monthly auctions yesterday and today. By last Friday the six-month bill had risen to 8 per cent and the June tax bill to 8.15 per cent on a discount basis--both in the neighborhood of 8-1/2 per cent on a yield basis At the higher rate levels, the Treasury had good coverage in the tax bill auction last Friday, but with banks in a tight position there is a substantial job of distribution to be accomplished through the market In yesterday's regular Treasury bill auction average rates of 7.48 and 8.03 per cent were established for three- and six-month Treasury bills, respectively, up 44 and 77 basis points from the auction just preceding the last meeting of the Committee. High as they were, these rates were lower than some of the early talk preceding yesterday's auction had suggested as the higher rate levels attracted some rather spirited bidding.

In view of the extent of the rate rise last week, one would expect some reaction towards lower rates to set in once today's auction of one-year Treasury bills is out of the way. Dealers--who have suffered significant losses on their bill portfolios, which have been

running about $3 billion or more for most of the month--are in a somewhat demoralized condition, however, and the task of distributing the new tax bills may keep the bill market under pressure for some time to come

Other short-term interest rates--on commercial paper and bankers' acceptances--also rose sharply over the period. The bankers' acceptance market had to contend with an expanded sale of acceptances by banks and there was increased evidence of interest in the sale of ineligible acceptances--indicating that more banks were attempting to shift general loan demand to that particular instrument. No real secondary market has as yet developed in ineligible acceptances, and while several of the acceptance dealers are acting as brokers at rates a shade above those applied to eligible acceptances, none is very enthusiastic about developing a market at the present time.

Open market operations over the period had to contend with a much larger reserve need than had been estimated at the time of the last meeting, with heavy bill sales by the German Federal Bank, and with the general deterioration of market psychology As you know, special Committee action was required on November 14 to increase the leeway for changes in System Account holdings of U.S. Government securities in the interval between Committee meetings from $2 billion to $3 billion. At the time the blue book[1/] was prepared before the last meeting, it appeared that only about $800 million in reserves would have to be supplied over the interval And on the day of the meeting, New York Bank estimates indicated a need to supply $1.1 billion in reserves, still well within the standard $2 billion leeway. The main reasons for the unexpectedly large reserve drain were the repayment of about $600 million in foreign currency swap drawings, and--reflecting the strength in the monetary aggregates--reserve absorption of $200 million each from higher than projected required reserves and currency in circulation. In fact, the System supplied over $2-1/2 billion in reserves over the period, with about two-thirds of the total taking the form of outright purchases of bills from foreign central banks. These System purchases tended to mitigate the net impact of heavy foreign bill sales on the market, but it is quite obvious that dealer positions would have been more manageable if foreign transactions had been more nearly neutral and the System had been able to buy more in the market. Pressure from German sales of

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

Treasury bills seems about over, and Germany's proposed drawing on the IMF may lead to some net buying of bills--at least temporarily--although we do not yet have a complete picture. The drawing will, of course, result in a cash drain of about $250 million on the U.S. Treasury, and this could conceivably lead to a Treasury decision to monetize some part of the $800 million in gold held in the Exchange Stabilization Fund.

The monetary aggregates are currently expected to be stronger in November than was projected at the time of the last Committee meeting. As the blue book indicates, total member bank deposits are currently expected to rise in November at an annual rate of 9 to 12 per cent--about 4 percentage points above the range projected a month ago, with a little over half of the difference explainable by the timing and size of the Treasury's bill financing and the downward revision of the October estimates. Money supply has been showing surprising strength this month and is expected to rise at an annual rate of 4 to 7 per cent compared to little net change anticipated at the time of the last meeting. Despite the strength in the monetary aggregates no effort was made to implement the proviso clause of the directive in view of the very substantial upward pressure on interest rates.

Looking to the period ahead, current projections do not indicate much of a need to supply reserves over the next three weeks. Total bank credit is expected to expand moderately in December--if current projections can be believed--while money supply is expected to decline a bit. However, the November strength in the aggregates--if it does not turn out to be a statistical illusion--is enough to suggest a modest increase in both bank credit and money supply for the fourth quarter in contrast to a decline and no change, respectively, in the third quarter. As far as the financial markets are concerned, there could be some reaction to the recent upsurge in interest rates, particularly if further indications of an economic slowdown appear and are believed by the markets. I would not be so sanguine as to predict this as likely, however, and we shall have to be alert to the possibility that demoralized markets might become disorderly. The outcome of the Board's proposed ruling on bank-related commercial paper may have an important bearing on market attitudes, depending on the seriousness of the adjustment problem for individual banks and the way they go about making any

necessary adjustments. Consequently, open market operations may have to be conducted flexibly with a close eye on possible market disturbances, but hopefully without any serious sacrifice of reserve objectives or of an over-all posture of restraint. If markets do come under renewed pressure there could be sizable storm-cellar interest in short-dated Treasury bills, which are in relatively short supply in the market at the same time that positions in longer-term bills are heavy. Under certain conditions it might make sense for the System to acquire longer-term Treasury bills by market purchases and to offset any undesired reserve consequences by subsequent sales of short-term bills that can be readily absorbed by the market.

I might note that the System carried out its first loans of securities last Thursday on an experimental basis. So far no major problems have emerged, but the volume has been quite small. The dealers have welcomed this move on the part of the Federal Reserve and have made a number of suggestions for improvement of our procedures. We are in the process of analyzing these proposals--some of which appear to be worthwhile--and we will come back to the Committee with recommendations if our study determines that certain modifications of our procedures would make for a more effective program. A letter from the Secretary of the Treasury to Chairman Martin stressing the Treasury's endorsement of the System action and promising further consideration of action by the Treasury to join the Federal Reserve in the lending of securities has been circulated to members of the Committee.1/

In conclusion, there would appear to be no need in the period ahead for the expanded leeway of $3 billion for open market operations in the interval between Committee meetings. I would therefore recommend that the continuing authority directive be amended to restore the $2 billion leeway previously in effect.

By unanimous vote, paragraph 1(a) of the continuing authority directive was amended to reduce the leeway for changes in System Account holdings of U.S. Government securities between meetings of the Committee from $3 billion to $2 billion. As amended, paragraph 1(a) read as follows:

1/ A copy of this letter, dated November 21, 1969, has been placed in the Committee's files.

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.

Mr. Mitchell asked whether his impression was correct that the tone of the market suggested that monetary policy had tightened recently.

Mr. Holmes replied that one's conclusions regarding the stance of policy in the period since the preceding meeting depended on the variables he considered. Thus, the day-to-day Federal funds rate and the marginal reserve measures had remained well in line with previous experience, suggesting no change; the monetary aggregates were strengthening considerably in November, suggesting easing; and interest rates had risen sharply since late October, suggesting firming. On balance, he thought it was reasonable to conclude that there had been no change in the over-all stance of policy, particularly since the rise in interest rates was clearly related to a turnaround in market expectations rather than to a change in underlying conditions.

Mr. Mitchell commented that the performance of the monetary aggregates in October suggested considerable over-all tightness. A table in the blue book contrasting growth rates in October and in the third quarter for nine key aggregates indicated weakening for five of the series--total and nonborrowed reserves, the adjusted credit proxy with and without an additional adjustment for funds from nondeposit sources, and savings accounts at nonbank thrift institutions. Only one of the aggregates--time and savings deposits at commercial banks--had strengthened significantly in October. He wondered whether the Manager was confident that the aggregates would be as strong in November as the projections suggested. In that connection, he noted that the money supply had grown less in October than had been projected earlier.

Mr. Holmes said he assumed that as usual the projections were subject to error. However, the strength now indicated for November had become increasingly evident as the statistics became available over the course of the month. In part, of course, the size of the projected November rise in the proxy reflected downward revisions in the data for October.

Mr. Mitchell observed that the October estimate was still being revised downward after the end of the month. He then asked whether Mr. Axilrod had any comments on the recent performance of the aggregates.

Mr. Axilrod noted that the bank proxy figure for October was still partially a projection at the time of the previous meeting. Considering the various reasons for the strength of the rise now projected for November--including the downward revision for October and the differences between the actual size and timing of the Treasury's tax bill financing and those assumed in the earlier projection--he thought it was reasonable to combine the two months for purposes of assessing the behavior of the proxy series. On that basis, the behavior was roughly in track with the earlier projection--perhaps one percentage point stronger.

In reply to questions by Mr. Brimmer, Mr. Holmes said that no specific allowance was being made in the projections for the possibility that the Treasury might monetize some of the gold in the Exchange Stabilization Fund. Treasury officials had been considering that possibility for some time and in his opinion the proposed German drawing on the International Monetary Fund made it somewhat more likely now. He had no direct information on the Treasury's thinking on the matter nor any knowledge of the amount of monetization that might be under consideration.

Mr. Brimmer then said that in his view the Committee should take account of the possible monetization of gold because of its potential impact on bank reserves. On another matter, Mr. Brimmer noted that foreign official balances at commercial banks had been growing rapidly in recent weeks. In conversations with foreign

officials in Paris, he had formed the impression that further growth in such deposits was to be expected.

Mr. Holmes observed that the Desk had been keeping track of the growth in those deposits, which had amounted to some $3/4 billion in recent weeks. It was also his impression that foreign official deposits might be built up further in the period ahead.

In reply to a question by Mr. Hickman, Mr. Holmes indicated that commercial banks in New York were paying rates on foreign official deposits that were competitive with those available in the Euro-dollar market.

> By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period October 28 through November 24, 1969, were approved, ratified, and confirmed.

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

Mr. Axilrod made the following statement concerning economic developments:

> For someone used to evaluating financial market developments, I thought it might be illuminating for a change to attempt to look behind the "veil of money"--to resurrect an old-fashioned term--and see if flows of

income, production, and expenditures are reflecting progress in our efforts to subdue inflationary forces. Needless to say, I have not found the path of analysis as well lighted as one would like. But fortunately the path seems a little more clearly lit than a month ago, as the October data--including such key series as the average manufacturing workweek, personal income, industrial production, and housing permits--appear to indicate that a weakening of economic activity is in process.

Inflation appears to be more clearly coming under control from the demand side than it does from the cost side. Consumer purchases of goods have risen quite moderately for the past few quarters, and monthly and weekly retail sales data do not suggest any resurgence of demand thus far in the fourth quarter. While some greater consumer spending cannot be ruled out in the current quarter in view of the sharp rise in the personal saving rate in the third quarter, what evidence we have on consumer buying intentions shows a weakening in spending propensities. Moreover, the September and October rise in personal income was at half the rate of earlier in the year. And impressive to me for the longer-run outlook of consumers was the third-quarter actual decline in spending on durable goods; this was the first significant quarterly decline since the first quarter of 1967.

In part because of diminished demand for consumer goods, businesses have begun to scale down production. Auto assemblies in October were down to an annual rate of 8.4 million units, and production for November and December is now scheduled to drop further The total industrial production index dropped for the third successive month in October, reflecting production adjustments to the sharp rise of inventory accumulation in the third quarter, with the inventory-to-sales ratio in the retail area in September moving above the late 1966 high. Production has declined at about a 3 per cent annual rate from its July peak, and a further decline in production seems probable in November, based on data so far available this month

The latest data on new and unfilled orders appear generally consistent with the prospect of weakening business output this month and in the months ahead. While the sharp, almost 6 per cent, rise in orders at durable goods manufacturers in September was only partly reversed in October, the largest declines occurred in areas, such as machinery and equipment, which had shown

the greatest increases in the previous month. Unfilled orders, too, dropped slightly in October, and the ratio of unfilled orders to shipments dropped for the third successive month.

In addition to autos, production declines have been especially large in apparel, in defense equipment industries, and in areas related to homebuilding. Housing starts in October dropped to a rate of a little over 1.3 million units, the lowest level since December 1967, and further declines appear in prospect, given current mortgage market conditions and the continued drop in building permits last month.

As to business plant and equipment spending, such outlays were raised somewhat in the revised third-quarter GNP figures. The McGraw-Hill survey indicates that businesses expect to increase real spending on plant and equipment by only 1 per cent in 1970 as compared with an estimated 5 per cent rise in 1969, with businessmen adding 7 percentage points to their planned 1970 rise because of inflationary price expectations. But the sluggish consumer demands, carrying with them the prospect of a fairly sharp further drop in plant capacity utilization, the currently very high interest rates which make it costly to build ahead of demand, and the developing squeeze on profits all suggest lower business capital spending than reported in the recent private surveys. We await, with bated breath, the Commerce-SEC survey, to be forthcoming early next month, but expect that it will confirm the progressive slowing of the rise in business fixed-investment outlays that we foresee over the next several quarters.

While the demand side of inflation appears to be coming under control--and I am making a critical assumption that Federal Government defense outlays will be declining from their third-quarter peak--we have not seen the results yet in an abatement of price increases and in cost pressures. Since I do not believe that the cost-push aspect of inflation can long persist strongly once demands are contained, I would expect that price increases may soon begin to slow. It's hard to see much evidence in current series, although the recent calming in sensitive industrial materials components of the wholesale price index could be a harbinger. But any slowing of a price inflation that has gone on as long as this one is not likely to develop without considerable frictions, affecting employment, wages, and profits.

With the best will in the world it is almost impossible to evaluate with confidence the current statistics on productivity. Output per manhour for the nonfarm sector as a whole appears to have been declining so far

this year, but productivity in the manufacturing sector appears to have held up better. In any event, unit labor costs are rising, and the third-quarter GNP figures do make it clear that corporate profits are beginning to decline.

In the face of declining profits, resistance to wage increases by employers should be enhanced, and prolonged strikes are a good possibility. But whether, even so, noninflationary settlements will result is open to question. On balance, taking account of the enlarged number of contracts up for negotiation next year and noting the high starting level in the current General Electric negotiations, compensation per manhour in the economy next year may increase at about the same rate as this year. As weakening aggregate demands limit businesses' ability to raise prices and protect profits as much as last year, the equilibrating mechanism called into play would, of course, be reduced output and increased unemployment. And it is possible that the level of unemployment could move up fairly rapidly if the current weakening of demands for goods and services accelerates, and businessmen begin to adjust their labor force to a more pessimistic longer-run outlook for production.

In the current situation, monetary policy is faced with a true dilemma. If wage settlements are going to continue above productivity gains, and demands are kept dampened, the unemployment rate could shoot up. On the other hand, if enough aggregate demand is permitted in the economy to allow some passing on of price increases and minimization of a profit squeeze, inflationary expectations may not abate. Under such conditions, monetary policy may wish to steer a middle course, particularly when recognition is given to Federal tax policy uncertainties.

By a middle course, I mean monetary policy may wish to contribute a little more than it has since mid-year to credit growth in order to hedge against the development of excessive unemployment. On the other hand, policy would not want to add so much to credit availability--given the pent-up demands for housing, and for State and local government spending--to encourage so much aggregate demand that price increases could be readily passed on. I would interpret such a middle course for policy as one that would encourage a rather modest growth in such monetary aggregates as money supply and total member bank deposits. There are options with respect to adjustments in both Regulation Q, so far as total member bank

deposits are concerned, and open market operations for achieving this. With respect to open market operations, I would think that alternative B of the draft directives[1/] moves in the direction of a sustainable middle course for policy.

Mr. Keir made the following statement concerning financial developments:

The unusual spectacle of the three-month Treasury bill rate rising by 1/2 of a percentage point between Committee meetings, at a time when the monthly credit proxy is projected to be rising at a 10 per cent annual rate, poses something more than the usual challenge in trying to interpret the financial effects of prevailing monetary policy One reason for the sharpness of the upsurge in market interest rates has, of course, been the recent shift in expectations about policy. As market participants have focused on the possibility of significant fiscal policy ease during 1970, many have concluded that the chances for near-term moderation in monetary policy are virtually nil--and they have been encouraged in this view by recent official statements.

The changed attitude on policy developed just as financial markets were beginning to enter the November-December period of maximum seasonal strain. This followed a year in which the general liquidity of the economy had already been severely constricted by the cumulative effects of tight money At the same time, the Board's proposed ruling on commercial paper issued by bank affiliates seemed to raise the spectre in financial markets of a further tightening of the liquidity squeeze on banks. Finally, the U.S. Treasury was preparing to undertake three successive bill auctions--one involving $2.5 billion of new money--in as many business days. In these circumstances, it is not surprising that rates rose sharply

However, the very steepness of recent increases suggests that any near-term developments which tend to modify the assumptions underlying current market expectations could quickly tip rates down again. For example, responsible Senate disposition of the debate just getting under way on the tax reform bill, further significant indications of general slowing in the economy, or evidence that the Board's commercial paper ruling will not intensify

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

monetary restraint would all tend to encourage some reversal of yields. Moreover, as Mr. Holmes has indicated, there are already some signs that yields at current advanced levels are beginning to attract investor interest. On the other hand, it would be wrong to conclude that recent rate advances have been solely a result of changed expectations. An additional basic factor underlying upward rate pressure has been the cumulative liquidity squeeze that has developed in the economy from maintenance of the System's prevailing tight policy.

Perhaps the most dramatic current example of a sector under liquidity strain is the nonbank thrift institutions. In the October reinvestment period, even before the further rise of rates, these institutions were faring poorly. Looking ahead to the more vulnerable January reinvestment period, prospects are thus for heavy additional net savings outflows. For the Federal Home Loan Bank System to make good on its commitment to continue providing both expansion and withdrawal advances, the magnitude of its borrowing in the market may, therefore, have to be pressed beyond the limits of recent experience. In the extreme case, if full coverage of an FHLB issue seemed doubtful, the Bank Board might have to turn to its tap on the Treasury. At the same time the Federal National Mortgage Association will have to continue borrowing at close to recent levels in order to meet its outstanding mortgage purchase commitments.

Nonfinancial corporations--while in less extreme straits than the thrift institutions--are apparently also coming under increasing liquidity strain, following the very large depletion--at a $6 billion seasonally adjusted annual rate--in their liquid assets during the third quarter, indicated by the preliminary flow of funds estimates. In the past when similar sizable seasonally adjusted reductions have occurred, they have typically been confined to periods when economic activity was slowing down. In the present case, although conclusive data are not yet available, the reduction in corporate liquid assets may have cut corporate liquidity ratios to new lows for the post-World War II period.

Since corporate profits are continuing to deteriorate, whereas outlays still appear to be rising, businesses can probably be expected to expand their immediate borrowing from the sharply reduced level of the third quarter. There has already been evidence of a little pick-up in

such borrowing both at banks and in the capital markets. An important question for the weeks ahead is whether corporations will try to draw much more heavily on credit lines to help cover their large December tax payments.

Thus far, my comments have stressed the interest rate and liquidity pressures being exerted by continued monetary restraint The question remains how point estimates for November showing annual growth rates of 10 per cent in the adjusted credit proxy and 5-1/2 per cent in the money supply can be reconciled with this picture of unrelieved financial strain. One answer is that because of a large seasonally adjusted swing in Government deposits, from rapid decline in October to rapid growth in November, the two months should be considered together--as Mr. Axilrod has suggested. On average the two months roughly offset one another in the credit proxy.

Even so, over the fourth quarter as a whole the change in the adjusted credit proxy is still projected to be slightly positive on balance. This represents a sizable improvement from the 9-1/2 per cent annual rate of decline experienced on average during the third quarter--although it does not give banks any leeway to improve their severely depleted liquidity. When account is taken of nondeposit sources of funds other than Eurodollar borrowing, fourth-quarter growth runs to a couple of percentage points on average at an annual rate. Also, the projection of money supply growth in the whole fourth quarter is positive by 1 to 2 percentage points.

One can suggest certain qualifications regarding the meaningfulness of some aspects of these recent money and deposit flow data--for example, the essential arbitrariness of applying old seasonal factors to the current substantially reduced levels of monthly CD maturities But the recent deposit flow experience does clearly provide some relief for the banking system compared to the rapid third-quarter attrition--abstracting for the moment from the nagging uncertainties now being created for bankers by the Board's proposed commercial paper ruling.

In short, given the projection of positive growth in fourth-quarter money and credit flows, the continued strength of inflationary expectations, and the still open question of Senate action on the surtax and investment tax credit features of the tax reform bill, I believe a reasonable case can be made at this time for continuing prevailing policy However, the Manager should be given ample leeway in the proviso to offset special pressures

which might arise in connection with possible bank regulatory changes. Also, if after today's monthly Treasury bill auction rates do not soon begin to recede from their advanced levels and move down well into the 7 to 7-1/2 per cent range specified by the blue book, it would probably be desirable for the Account Manager to run other money market conditions near the low ends of their specified ranges.1/ An adjustment of this type would help to dissipate the threat of disorder that has occasionally been present in the market recently.

For the longer run the Committee should also recognize that continued maintenance of growth in the money and credit aggregates at or slightly above the annual rates estimated for the fourth quarter will probably not be possible without some relatively near-term easing of money market conditions from presently specified levels. This would be particularly so if a slowing of economic activity begins to be reflected in a significant lessening of loan pressures on banks and in an associated unexpected shortfall in the banking aggregates.

Mr. Hickman said that the blue book specifications for alternative B of the draft directives seemed to call for essentially the same policy as Mr. Keir was suggesting be pursued under alternative A--namely, some slight easing in short-term market rates.2/

Mr. Keir observed that the blue book was drafted before the three-month bill rate had reached its current level near the top of the 7 to 7-1/2 per cent range specified for alternative A. His point was that it would be desirable to get the bill rate well back

---

1/ The ranges specified in connection with alternative A for the directive were 8-1/2 to 9-1/2 per cent for the Federal funds rate, $1 billion to $1-1/2 billion for member bank borrowings, and $900 million to $1.2 billion for net borrowed reserves.

2/ The blue book passage describing money and short-term credit market conditions that might be associated with alternative B read as follows: "The slightly less firm money market conditions might involve Federal funds more frequently around 8-1/2 per cent, member bank borrowings around $1 billion or a little less, and net borrowed reserves fluctuating around $800 million. The 3-month bill rate under these conditions might move down into 6-7/8 - 7-1/8 per cent range. ."

into that range. Adoption of alternative B, on the other hand, would involve fostering some further decline in the bill rate beyond what he was recommending at this time.

In reply to a question by Mr. Brimmer, Mr. Keir said that while he recommended adoption of alternative A, he would stress the importance of the proviso relating to possible pressures in connection with bank regulatory changes and the desirability of not offsetting declines in bill rates.

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

> The tensions in domestic financial markets and the crosscurrents in U.S. markets for goods and services are having their counterparts in the country's external transactions. A very important indicator to watch now is the merchandise trade balance, both because its changes may throw some indirect light on the state of the domestic economy and because the degree to which it improves over the coming year will give us a clearer idea of what will still have to be done, in other countries as well as here, to restore equilibrium in international payments.
>
> Figures have just been released for October trade, too late to be included in the supplement to the green book.1/ No definite conclusion about the strength of the improvement that seems to be starting can be drawn from these figures. On the import side, the last four months' figures have shown a zigzag movement without much net rise or fall. But one cannot feel confident that imports have really leveled off, because the zigzag was up in the latest month, October, to a level exceeded only in one month before--last May. We know that the pace of import arrivals in the second quarter was abnormally high, as a result of the catching-up process in the wake of the long port strike at the beginning of the year. No such explanation can excuse the high October figure.
>
> On the export side, we can be fairly confident that the upward trend of the past two years is again asserting

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

itself after the interruption and losses associated with the port strike. Exports in September and October, averaged together, were at a record level, 14 per cent above the corresponding months a year ago. By this time we can assume that after-effects of the port strike are no longer a major factor pushing exports up. On the whole, the prospects seem good for further expansion of exports in the coming months. Agricultural exports in the current quarter may not do quite as well as in the third quarter, and Canadian demand for U.S. products may be leveling off, but in Europe, Japan, and the less-developed countries in general, demand for materials and for machinery seems to be very strong.

The over-all balance of payments on the liquidity basis has shown a marked improvement in the past two or three months. Recent weekly figures have been erratic, however, and it seems fairly clear that the improvement has been mainly in the more volatile elements of capital flows, some of which get reported only with a considerable lag and others not at all A major factor, it may be assumed, has been the massive outflow of funds from the German mark in the past two months, which is now tapering off.

Thanks to the decision at the IMF meetings to go ahead with allocation of SDR's next January, to the German decision to revalue, to the renewed pressures that U.S. banks have been placing on Euro-dollar interest rates in recent weeks, and to the South African balance of payments, the gold market has been putting a high valuation on the U.S. dollar lately. This is a pleasant sight, and it may have an enduring psychological impact, but no one should take it as a sign that the dollar's troubles are all over.

The turnaround in U.S. financial markets since the latter part of October has been paralleled by a cessation of the runoff in U.S. banks' Euro-dollar borrowings from their branches and a renewed buildup this month. At the close of business last Friday, liabilities to branches plus branch participations in domestic loans were within about a hundred million dollars of the $15.4 billion peak that was reached at mid-October. Euro-dollar interest rates dropped briefly to around 9 per cent before the end of October, but the three-month rate is now again above 10-1/2 per cent. These developments are of course helpful in a very short-run sense for the U.S. official settlements

balance, but unfortunately, from our point of view, they tend to add to the upward pressures that are being put on European interest rates generally. Only in Germany is official policy resisting these upward pressures.

The outflow of funds from the German mark has of course tended to have a tightening effect in the German money market, but the German Federal Bank has resisted this through action on reserve requirements, reversing the 10 per cent increase that had been put into effect at the beginning of August. German official policy continues to aim at maintaining a large outflow of long-term capital--even though not so large as in the first three quarters of this year, when it was at an annual rate of over $4-1/2 billion. For the present, at least, we could hardly ask for better cooperation in international monetary matters than Germany is giving.

As I suggested when I was talking about the hoped-for improvement in our trade balance, a year from now we may again--or still--be looking for additional cooperative actions by Germany and other surplus or potential-surplus countries. Quite possibly they may then be accumulating large amounts of dollars in official reserves, including gains accruing as the result of U.S. banks' repayments to their branches and consequent relending by the branches to European and Japanese borrowers. The strength of the U.S. position in policy negotiations at that stage will depend partly on the degree of success this country can show for the effort to check inflation.

Chairman Martin then called for the go-around of comments and views on economic conditions and monetary policy. He observed that the Board members would welcome any comments the Reserve Bank Presidents cared to make on the Board's proposal of October 29, 1969, to apply Regulation Q to funds received by member banks from the issuance of commercial paper or similar obligations by bank holding companies or collateral affiliates.

Mr. Hayes then began the go-around with the following comments:

The mixed character of the recent business news seems reasonably consistent with the general expectation of moderately slower growth of GNP for the current quarter and through the middle of next year. But against the sluggishness of personal income, retail sales, and corporate profits, and the considerable weakness of housing, we have to weigh the strength of business capital spending plans and above all the growing evidence that fiscal policy is moving decisively in the direction of stimulus. At the same time price pressures seem about as powerful as ever, wage demands appear to be accelerating, and inflationary psychology is widely prevalent. Labor continues scarce in most markets, and while there may have been some modest easing of this scarcity the reported unemployment rate probably exaggerates the extent of this development. Thus, it remains very doubtful whether the slowdown will be substantial enough or last long enough to make a serious dent in the problem of inflation. I am inclined to agree with Mr. Daane that a rather prolonged policy of monetary restraint will be a necessary condition for such progress.

I find the fiscal situation profoundly disturbing. In current discussions of possible wage and price controls it is commonly argued that such an approach is undesirable and also unnecessary in view of the fact that monetary and fiscal restraint are inherently more effective and are now being applied vigorously. Yet, the unpleasant truth is that fiscal restraint is rapidly disappearing if it has not already done so. There is now a good deal of doubt whether even a small Federal budget surplus will indeed be achieved in fiscal 1970, in the light of large proposed outlays for social security and Federal pay increases, the probable difficulty of carrying out the $4 billion of loan sales now included in the budget, and uncertainties as to Congressional tax action. All the evidence suggests that the budget will be more expansionary in calendar 1970 than in 1969. I am more convinced than ever that it was a serious mistake to propose cutting the surtax from 10 per cent to 5 per cent as of January 1, 1970.

On the international side we have much to concern us, despite the vast improvement in the exchange markets resulting from the German revaluation. The huge size of the 1969 U.S. payments deficit on a liquidity basis points to a difficult problem at such time as a slackening of credit pressures in this country brings a large-scale

reduction in borrowings by American banks from their overseas branches. This is, of course, not an immediate problem, but to me it suggests that the System would do well to take measures to discourage a further build-up of these borrowings, whereas I have recently sensed a feeling of satisfaction in some Government quarters whenever these borrowings rose further and thereby added, for the moment, to our official settlements surplus. Those of us who attended the latest Basle meeting heard many worried comments not only on the prospect of sharply higher central bank holdings of dollars whenever our credit policies are eased, but also on our failure so far to stem our inflation, and on the alleged dilemma in which this has placed various countries of choosing between being tied to a depreciating dollar and being forced to revalue. Clearly we face another major international payments crisis within the next year or two unless we do make significant progress against inflation.

The banking and money indicators continue on balance to show very modest growth. Despite considerable strength in November, a pronounced slowdown has been evident in most series dating from about midyear. In contrast with total bank credit, however, bank loans, adjusted for loan sales to affiliates, have risen substantially since midyear--at an annual rate of over 10 per cent in the case of business loans. A recent acceleration in consumer loans may reflect an effort by consumers to maintain their expenditures as the growth of personal income slackens. In general credit demands remain heavy both in the short-term area and in the capital markets. The banks have had to turn their attention increasingly to the Euro-dollar market, and the total of such borrowings would have risen much more sharply in recent weeks had it not been for a rise of nearly $1 billion in time deposits from official foreign organizations that are exempt from Regulation Q.

With respect to policy, I feel that present circumstances clearly call for no change in the existing degree of restraint. There is still widespread skepticism that the System will persevere in the anti-inflationary battle, and I can see large risks in any general policy relaxation that could give a signal for new inflationary activities. The targets agreed upon at the last meeting still seem appropriate, namely, Federal funds rates of 8-1/2 to 9-1/2 per cent, member bank borrowings of $1 billion to $1.5

billion, and net borrowed reserves of $0.9 billion to $1.2 billion. The 3-month bill rate, after its sharp rise of recent days, is well above the 6-3/4 to 7-1/4 per cent range mentioned at the last meeting. Perhaps 7-1/8 to 7-5/8 per cent might be a realistic range to expect in the coming weeks.

While I would hope that the Board would go through with the proposal to subject bank-related commercial paper to Regulation Q, I think it should be recognized that this will place substantial additional pressure on some of the banks that have been using this device on a large scale. Recognizing the disadvantages of forcing large additional Euro-dollar borrowings and the desirability of making a start toward raising Regulation Q ceilings to more realistic levels--including some change in the ceilings on savings and personal time deposits--I would suggest that the action with respect to commercial paper might provide an opportunity for some modification in the Q ceilings without risking misinterpretation as a move toward a general easing of policy, particularly against the background of current interest rate levels. And in the event that such a misinterpretation were to occur, other means of making our intentions clear are available.

As for the directive, alternative A seems quite appropriate. Again, I would think it well to implement the proviso clause only if credit developments were to diverge quite widely from the projections; and I would agree on inclusion of the second proviso, to permit mitigation of any special pressures that might arise from a Board regulatory change with respect to bank-related commercial paper. And, in the light of the unsettled state of the financial markets, we might face the need to act decisively to avoid disorderly market conditions from emerging. I would not think it necessary to amend the directive to provide explicitly for this contingency, but I would permit the Manager a great deal of flexibility in the conduct of operations if it turns out to be needed.

Mr. Morris remarked that during the four weeks since the Committee's last meeting substantial additional evidence had been received that the economy was cresting. The leading indicators, which had leveled off since April, showed a pronounced pattern of

weakness in October. Of the seventeen leading indicators for which October data were available, twelve had declined and only five had advanced. Of the five which had advanced, none had established new peaks in October and at least one--common stock prices--had already lost all of its October gains.

Mr. Morris thought it was now possible to verify a clear upward trend in unemployment and clear downward trends in industrial production and in the rate of growth of incomes. Last week he had attended the Outlook Conference at the University of Michigan where Professor Katona, head of the Survey Research Center, had unveiled his latest survey of consumer attitudes. The survey showed a very sharp decline in consumer confidence from earlier surveys, and the current index of consumer confidence was at its lowest level since 1958. Professor Katona had concluded that, in the absence of some dramatic change such as peace in Vietnam, he would expect a very weak consumer performance and a resulting recession in 1970. Mr. Morris thought that Professor Katona's findings were worth considering, particularly since they seemed to be confirmed by the weakness in the automobile market. For those and other reasons, he (Mr. Morris) was convinced that the Committee's policy had been successful and that the statistics of the next few months would confirm its success.

However, Mr. Morris was concerned that the present course of policy might generate a serious financial crisis in the interim

before all the results were in on general economic activity. He was confident, of course, that the Committee could meet a financial crisis if one developed, but he would count it as a failure of policy if one did develop. He considered as highly significant the following statement in the current green book: "...bank liquidity positions fell further in October, reaching new lows well below those in late 1966." He thought it unfortunate that there was no elaboration of that theme and he suggested that the Board's staff prepare for the next meeting an analysis of the liquidity position of the banking system and its implications for developments in 1970.

It was Mr. Morris' judgment that in concentrating its attention on the ability of the banks to attract nondeposit sources of funds, all of which would constitute claims against bank resources in 1970, the System had overlooked what he considered to be a very serious deterioration in bank liquidity in 1969. He had asked his staff to develop some comparisons of the liquidity position of the weekly reporting member banks in the First District in 1966 and 1969. The staff had reported that at the low point in 1966 the ratio of net liquid assets to deposits was about 5 per cent. The current net liquidity ratio was below zero; short-term nondeposit liabilities substantially exceeded total liquid assets. He thought those numbers, which certainly were not peculiar to the First District, told something about the ability of the banking

system to withstand additional strains. They also suggested that there might be a considerable "liquidity hangover" in 1970 as those very large short-term nondeposit liabilities were unwound. The liquidity strains were not limited to the banks but were widespread throughout the financial system.

Mr. Morris said he wanted to compliment the Board's staff for some significant insights into the erosion of liquidity in the corporate and the State and local government sectors in the analysis presented in the supplement to the green book. All of that evidence added weight to his thesis that the present policy course, if adhered to much longer, could well generate a liquidity crisis.

For the first time this year, Mr. Morris said, he had scented the odor of panic in the financial markets last week. It was a rather faint scent and it had passed away yesterday afternoon, but he believed it would recur. One of the prime sources of concern could easily be eliminated, namely, the fear that the Federal Reserve Board would make effective its proposed regulation of commercial paper issued by bank holding companies on December 2, shortly before the peak period of seasonal pressures on short-term money markets. That possibility had added an unnecessary burden of uncertainty for a very weak market to carry. He would strongly urge the Board to announce soon that any new regulations concerning commercial paper which might be forthcoming would not become

effective until January, when the seasonal pressures on the markets would begin to ebb. He would also urge a more even-handed treatment as between paper issued by subsidiaries and holding companies. The present discrimination seemed to him to be unjustified, although he understood there might be some legal considerations involved.

Mr. Morris said he would subscribe to the "middle" policy course advocated by Mr. Axilrod for two reasons. First, if the Committee was, in fact, following a gradualist policy aimed at curbing the inflationary spiral, he thought the economic indicators suggested that it was attaining its objectives. The Committee was, at long last, getting the kind of readings from the indicators that it had been looking for. Second, he thought the minor modification of policy implicit in alternative B was required if the Committee was to avert the liquidity crisis which he believed might now be impending.

To those Committee members who disagreed with his judgments, Mr. Morris said, he would like to suggest that they look upon alternative B as a little insurance against a big mistake. He was sure that, in the turbulent markets of the next three weeks, not many would notice that the Committee had taken out that insurance. If the statistics of the next three weeks did not support the premise, then the Committee could revert to its current policy. However, he was reasonably confident that the incoming statistics would support the modest move he was proposing.

In short, Mr Morris said, he wanted to reverse the argument that he had heard many times around the table--the argument that it would not hurt to maintain the current policy for the next few weeks and then change it if events so dictated. As an alternative, which he thought was appropriate to current circumstances, he would propose that the Committee adopt alternative B today and shift back to alternative A three weeks hence if the incoming statistics did not support the change.

Mr Coldwell reported that economic and financial conditions in the Eleventh District were still riding a high-level crest. Industrial production declined in September when crude oil production was cut back, but manufacturing output other than petroleum continued upward. Construction contracts dropped sharply in September, but the cumulative value of contracts remained 3 per cent over 1968. Employment was virtually constant and unemployment declined, with the September rate at 2.6 per cent in Texas Agricultural developments included further cuts in cotton output but additional advances in cattle and livestock. Cash receipts from farm marketings averaged 8 per cent higher in the first three quarters of 1969 than in the comparable period of 1968, with all of the gain reflected in a 14 per cent advance in livestock receipts.

Turning to District financial conditions, Mr Coldwell noted that at banks there had been declines recently in most major balance-sheet items except investments. At twelve major Texas banks, total

loans had declined $72 million since October 1 while total deposits had fallen $282 million. It would appear that those banks were severely rationing credit, but were losing deposits so rapidly that their over-all liquidity was still declining.

Nationally, Mr. Coldwell said, he was beginning to see more convincing signs of an economic slowdown, especially in consumer takings and inventory build-up. Residential construction was still slowing and labor demand seemed to be weakening. The strong elements remained the capital spending of business and the very large construction demand represented by the suppressed credit requirements of municipal and State governments and residential builders. Looking toward the economic future, further slowing in factory output seemed likely as inventories became burdensome. Additional increments of unemployment also were probable as production efforts were reduced. One might expect some impact on plans for capital spending, but inflationary attitudes die slowly and businessmen still seem convinced that there would be only a short slowdown followed by a further inflationary advance.

Mr. Coldwell commented that on the financial scene the market congestion in Treasury bills, coupled with a strong reversal of the October rally, had created some apprehension despite very heavy System provision of reserves. Open market purchases of $3 billion since October 1 had laid a foundation for new credit extensions which could mean at least a marginal retreat from the

Committee's posture of restraint. In fact, the October rally seemed to gain some comfort from the System's purchases, and the impact of the failure to ratify expectations was just that much more severe.

Mr. Coldwell observed that bank deposit losses continued to place strong pressure on bank liquidity, and banks saw more and more customers placing funds in, and borrowing from, nonbank financial sources. As those trends intensified, bankers believed they were unreasonably and unfairly treated, especially by the impact of Regulation Q. While he was not sure how a ceiling-rate change would be received, he did think it would be needed soon. Such a move could provide some relief to banks and perhaps reduce the pressure for additional System provision of reserves.

As to open market policy, Mr. Coldwell said he favored a steady degree of pressure with a minimal backing away to relieve market strains. He was particularly interested in slowing the rate of acquisition of securities by the Federal Reserve because he believed the System had been overly generous in the past few weeks, especially since growth in the credit proxy had moved above the projected range. He knew the market was suffering from an excessive supply of bills and the market tone had deteriorated, but he was concerned about the possibility that credit extensions from the new reserves might be greater than desirable for a steady restraining policy.

Turning to the directive, Mr. Coldwell indicated that he favored alternative A for the second paragraph. He hoped the proviso would be implemented promptly if the rate of bank credit and money supply expansion approached the upper limits of the projected ranges. As to the first paragraph, he would suggest amplifying the statement on interest rates to indicate that the excessive supply of new bills had been a major factor in the recent sharp advance in rates.

As he had noted at the previous meeting, Mr. Coldwell said, he favored regulatory action with respect to bank-related commercial paper, coupled with an increase in the Regulation Q ceilings on very large-denomination CD's. He was concerned about certain discriminatory aspects of the regulation, however, if it was made to apply only to bank holding companies and collateral affiliates of banks. On that basis the regulation would not reach certain nonbank trustee corporations in the Eleventh District. Perhaps, however, there was no legal basis for covering those organizations.

Mr. Swan reported that in the Pacific Coast States the unemployment rate declined in October by 0.1 to 4.7 per cent. Employment in the aerospace industries continued to fall, reaching the lowest level since mid-1966. District housing starts were down in October, but by less than in the nation as a whole; for the first ten months of the year starts were above the level of

the corresponding period of 1968 even though rates on conventional mortgages on new homes were higher in the Twelfth District than elsewhere. The Reserve Bank's sample of five savings and loan associations--which had given an accurate early indication of the substantial outflow in October--suggested that outflows in November would be much smaller. Moreover, the November outflows appeared to involve mainly withdrawals of Christmas club savings accounts. Of course, even a small outflow in November would represent weakening relative to November of 1967 and 1968, when there had been net inflows.

With respect to monetary policy, Mr. Swan said he could summarize his position simply by saying that he agreed completely with Mr. Keir's recommendation, for the reasons the latter had advanced. In favoring alternative A he would emphasize, as Mr. Keir had, his concern about the course of bill rates; and he would stress the importance of promptly implementing the proviso language relating to bank regulatory changes if the need arose.

Mr. Swan commented that commercial banks, at least in his District, were interpreting the proposed regulation of bank-related commercial paper as involving not the maintenance of prevailing monetary restraint but a further general tightening of policy. None of the bankers with whom he had discussed the matter seemed to have in mind the possibility of offsetting open market operations. He personally thought that, in view of the actions the Board had already taken with respect to other nondeposit sources of funds, equity considerations argued for also acting on

commercial paper However, he believed serious consideration should be given to delaying announcement of the action until after the December period of peak pressures in financial markets had passed. He was not sure it would be sufficient for the purpose of avoiding augmentation of market pressures to place a later effective date on an action announced early in December He also would favor giving serious consideration to some concurrent adjustment of Regulation Q ceilings.

In a concluding observation, Mr. Swan noted that the System recently had taken a number of regulatory actions, each directed at nondeposit funds of a particular type. It was reasonable to expect that there would be a need for further actions, given the ingenuity of bankers in developing new sources of funds. Accordingly, it might be desirable at some point to consider whether some comprehensive approach to the problem might be developed that would obviate the need for separate actions relating to particular sources of funds. Such an approach might well require new legislation and obviously would not be applicable to the immediate situation.

Mr Galusha remarked there was some good news in the most recent green book but not enough, he thought, for the Committee to change policy this morning. He was skeptical that the surcharge was going to be extended; and if he might indulge in understatement, he was not reassured by Congressman Mills' recent call for a 20 per cent increase in social security benefits. It seemed to him that

the Committee was uncertain enough about future Government spending, and also about business investment spending, to put off changing policy for a while yet.

Mr. Galusha thought it would be unfortunate if fiscal policy became more expansionary, as it well might, and if the System was therefore forced to remain about as restrictive as it had been. The scope of the business of banks had perhaps already been permanently narrowed. The housing situation was getting more and more serious, he believed. And shifting resources from State and local governments would seem to make precious little sense socially. It would take a braver person than he, however, to put getting the proper pattern of spending ahead of reducing inflationary pressures.

Although he was not in favor of easing Committee policy, Mr. Galusha continued, he was opposed to increasing monetary restraint. He was therefore deeply concerned about the Board's recent announcement that it might apply Regulation Q to holding company commercial paper. He doubted the desirability of doing that. The System had already gone rather a long way in restricting banks in their historic role as financial intermediaries. And to what end had never been clear, at least to him. It certainly was a possibility, though, that if bank reserves remained unchanged, monetary restraint would increase should Regulation Q be applied to commercial paper. But how much nobody could be quite sure. The Committee should, then, possibly through Mr. Holmes, do whatever was required to keep

monetary policy from becoming more restrictive. It might be enough to keep the Federal funds rate roughly unchanged. He hoped so, since that was something the Committee could do.

Mr. Galusha saw little difference between alternatives A and B for the directive as elaborated upon by Messrs. Axilrod and Keir. The latitude the Desk had to have through the forthcoming period made the definition of a constellation of goals extremely difficult. "To prevent demoralized markets from becoming disorderly" was not only an inspired addition to the lexicon of the Committee, but a succinct and accurate statement of an appropriate objective through this period.

Mr. Scanlon reported that despite confusing crosscurrents, it appeared that total manufacturing output in the Seventh District had declined slightly in the past month or two. There had been no slowing in the uptrend in prices, and worker compensation increases had accelerated. The general public showed growing impatience with the results of restrictive monetary and fiscal measures, despite assurances that the situation would be worse in the absence of those measures. A few employers found labor somewhat easier to recruit in recent months but most reported no improvement, or even a further deterioration, in both the number and quality of workers that could be recruited in the labor market.

Mr. Scanlon said it had been noted that some District industries had cut output in recent months, including the automobile

industry. Passenger car output schedules had been reduced because of high inventories and disappointing sales. Output would continue below last year in December and January. At the same time demand continued good, or had strengthened, for steel, trucks, paper, electrical apparatus, and most types of business equipment. Orders for some types of capital goods were at a record in October.

Mr. Scanlon observed that District bank loan figures, even when adjusted for sales to affiliates and others, appeared relatively weak thus far in the fourth quarter in nearly all loan categories. However, responses to the November lending practice survey did not show as much weakening in business loan demand as respondents had projected last summer; and the majority of respondents were anticipating no change in demand in the period ahead. In any event, the loan data had serious limitations at this time as an indicator of strength of credit demand, given the rather long-standing restrictive loan policies of most banks.

Mr. Scanlon said there was every indication that the pressure on the money market banks had increased and that some smaller banks had become more restrictive in screening loans in view of their low liquidity. Deficit positions of the major banks were deeper than ever in spite of the leveling off in loans. On balance, they had not acquired any significant amount of funds through nondeposit sources in recent weeks. Some survey respondents reported moves to more restrictive policies on consumer loans and several reported much more restrictive policies on other loans.

Although not evident in interest rates, Mr. Scanlon continued, changes in monetary and credit aggregates in October and November implied a somewhat less restrictive monetary policy than in the third quarter. He considered that an appropriate development. As to policy, he would like to continue about the prevailing firm conditions in money and short-term credit markets, recognizing the temporary distortion in interest rate levels. He would hope that involved a modest rate of growth in the monetary aggregates. In terms of money supply, the 3 per cent annual rate now projected for October-November combined would be satisfactory. He believed the difference between the two alternative directives was not very great and hinged largely on the validity of the projections. Since he supported Mr. Keir's prescription for policy, he favored alternative A.

It appeared to Mr. Scanlon that the Board's proposal on commercial paper had had a sobering effect on the issuers of such paper, at least in the Seventh District. Those banks viewed the proposal as involving additional monetary restraint. He thought implementation would place considerable additional pressure on a relatively few banks which were already under pressure. Like Mr. Hayes, he would be unhappy to see the affected banks increase their Euro-dollar borrowings to offset commercial paper losses. He would hope that action on commercial paper might be deferred until the first of the year; given the effect of the announcement

itself, there did not appear to be much danger of a large increase in outstandings in the interim. If the proposal was implemented earlier, he would favor a concurrent action on Regulation Q ceilings to give money market banks a little relief with respect to large-denomination CD's.

Mr. Clay said that assessment of the economic situation reconfirmed the judgment that the restraint of price inflation had to continue to be the Committee's primary objective. There was confirming evidence of economic changes of the kind that were a necessary forerunner of a lessening of inflationary pressures. At the same time, price inflation continued at a very strong pace, and inflationary expectations were still pervasive On balance, the rate of aggregate economic expansion had moderated and it had to moderate further, resulting in some additional slack in the economy, before price inflation could be dealt with successfully. Thus, the more unpleasant part of the battle against inflation, and the real test as to the determination and willingness to deal with it, lay ahead.

Mr Clay thought public economic policy had to exercise a strong restraining force on the economy if more orderly economic developments, including stability of prices, were to prevail Unfortunately, the prospects were that fiscal policy would become progressively less restrictive and, in fact, might become expansive. The cost-push aspects of the inflation problem and the importance

of labor contract negotiations were complicating factors for the effectiveness of monetary policy. However, pursuit of a restrictive monetary policy with its impact upon the demand for goods and services, business profits, and the demand for labor could have a salutary influence upon those negotiations.

In view of the prevailing inflationary situation, Mr. Clay said, monetary policy should be continued essentially unchanged. Alternative A of the draft directives appeared to be satisfactory.

Mr. Clay said he had not yet reached a firm conclusion regarding the proposed commercial paper regulation, and had been planning to give the Board his views in a few days. At the moment he was inclined to share Mr. Scanlon's views that the action would put a great deal of additional pressure on a few banks and that a delay in its implementation would be desirable.

Mr. Heflin remarked that the latest economic information for the Fifth District supported his earlier impression of a slowing in the pace of business. The long-standing slump in major sectors of the textile industry continued and the Richmond Bank's latest survey suggested a tapering off in other manufacturing lines as well. There were an increasing number of reports of easing labor markets, although they seemed to be concentrated mainly in those parts of the District where textiles predominated. Construction activity remained in a steep decline, with reductions now reported in commercial and industrial building as well as in housing.

As for the national economy, Mr Heflin said, the most recent statistics were less disturbing than those of a month ago. Despite the upward revision in the third-quarter GNP, the revised figures for final sales and inventories gave the third-quarter performance a distinctly less bullish tone than the preliminary figures had suggested. The latest decline in housing starts more than offset the unexpected September rise and the October data on durable goods orders took some of the sting out of the sharp increase the month before. Moreover, there had now been three consecutive monthly declines in the industrial production index and two successive months of reduced growth in personal income. In addition, some slowing in inventory demand, even in the current quarter, appeared a definite prospect. While the continued strength in the business investment sector could not be ignored, it might be less appropriate to view that as an offset to weakness in other sectors than as a sign of the kind of basic imbalance that could be expected to slow the advance in the near-term future.

Mr. Heflin observed that, for some reason, that kind of assessment did not appear to have worked its way into the climate of expectations in credit markets. The recent weakness in the bond market was no doubt partly due to technical conditions and to the large supply overhang in both the corporate and the tax-exempt sectors. But he thought the experience of the last two months pointed up the highly volatile state of expectations and the

strong possibility of alternating swings in yields during this period of uncertainly over the business outlook and over Vietnam. A few more bearish business statistics should go a long way toward improving the underlying market tone, but if for any reason bond prices should show further signs of deterioration it might be appropriate for the Desk to increase its activity in coupon issues in meeting seasonal reserve needs.

With respect to policy, Mr. Heflin said the argument for some relaxation seemed stronger to him today than it had at the Committee's last meeting. But while substantive evidence that the boom was slowing might now be appearing, he could not yet feel that the Committee was over the hill in its efforts to contain inflation and inflationary expectations. So far as he could see, a solution to those problems required that growth in aggregate demand be held well below the third-quarter rate for perhaps three or four quarters in the future. Prospects now appeared good that that would be the case in the current quarter. But the situation that seemed to be developing with regard to the Federal budget left him considerably less confident about the first half of next year. Indeed, the potential slippage of fiscal policy was his greatest worry; he believed the odds were now against extension of the income tax surcharge and repeal of the investment tax credit, and that they were in favor of a rise in Federal expenditures. Accordingly, while he thought Mr. Axilrod's presentation today had been excellent, he favored alternative A for the directive.

Mr. Heflin said he agreed completely with Messrs. Galusha and Scanlon that it would be unwise for the Board to implement the proposed commercial paper regulation at this time. In fact, he was dubious about the proposal in general. As a lawyer he had considerable difficulty in understanding the legal basis for the proposed action; he knew the definition of deposits was elastic, but it could be stretched too far. Moreover, implementing the proposal would seem to validate the view of those who thought the System was unduly preoccupied with the allocation of reserves as opposed to their aggregate level. He thought the proposed regulation would in fact involve additional restraint, given the form of the Committee's directive, and in his judgment the commercial banks were now under the maximum feasible restraint. More generally, it was his impression that banks were becoming highly confused by the stream of official announcements relating to proposed and actual regulatory actions by the System.

Mr. Mitchell said he favored maintaining the policy of monetary restraint the Committee had been following, particularly as far as outward appearances were concerned. The monetarists who were predicting a serious recession under the current stance of policy were helping to abate the prevailing inflationary psychology, but they could not do the job alone. Accordingly, it was necessary to convince people that monetary restraint would continue for some time.

Mr. Mitchell remarked that if it were possible to moderate the degree of restraint slightly without appearing to do so he would be inclined toward alternative B for the directive today, but he was not sure that could be done with the tools at the Manager's disposal However, since there had been some relatively large swings recently in borrowings and net borrowed reserves, it was conceivable that some small reduction in the average levels of those variables could be achieved without creating the impression that policy had changed.

Mr. Mitchell concurred in Mr. Scanlon's view that modest growth in the monetary aggregates would be desirable. He would be quite comfortable with the stance of policy if demand deposits were to expand at a rate of about 3 per cent, not only on average in October and November but also in December. Another possibility would be to provide for some growth in time deposits by making an adjustment in the Q ceilings. He thought such action should be taken at some point, whether or not the proposed commercial paper regulation was implemented.

Mr. Daane commented that he agreed in general with the thrust of Mr. Hayes' remarks today and with the policy prescription of Mr. Keir. He remained doubtful about the staff's projections for weakening demand in the Government sector, and despite the University of Michigan survey Mr. Morris had mentioned he was skeptical that consumer demand would be as weak as projected.

On the latter score, he noted that the staff had projected that on average in 1970 personal saving would be at the very high rate of 6.7 per cent that had been reached in the third quarter. He found that projection particularly unconvincing. Against the background of those doubts, and of the continuing evidence of pervasive inflationary expectations, he would hold to a steady policy course under directive alternative A. He favored giving the Manager sufficient flexibility to deal with contingencies in the manner the latter thought proper.

Mr. Daane added that the potential slippage in fiscal policy was one of the main considerations which had led him to favor an unchanged monetary policy at this juncture. For that reason he was a little troubled by the absence of any reference to fiscal policy in the staff's draft of the first paragraph of the directive.

Mr. Brimmer said he also favored alternative A for the directive. He had arrived at that preference basically on the grounds set forth by Mr. Keir, whose presentation this morning had been particularly good. Unlike some other members of the Committee, he (Mr. Brimmer) did not dispute the staff's projections; there was no doubt in his mind that the economy was slowing. Since that had been the Committee's objective, however, he thought it did not argue for providing banks with resources that would be used to finance greater spending. The fact that

business loans adjusted for sales to affiliates had increased at a 10 per cent annual rate since midyear suggested that banks were still determined to accommodate their customers and that the customers were still determined to get all the funds possible.

Mr. Brimmer remarked that like others he was concerned about the outlook for fiscal policy. Apart from the uncertainty about taxes, it seemed unlikely that Federal expenditures would be held down to the level sought by the Administration. A great variety of arguments were being advanced to justify additional expenditures. For example, this morning's papers reported that the Administration was proposing an increase in the resources of the Export-Import Bank for the purpose of expanding U.S. exports. While that action might help the balance of payments, it would, of course, also add to Federal outlays.

Mr. Brimmer referred to the monetarists' forecasts of a severe recession that Mr. Mitchell had mentioned and noted that in his (Mr Brimmer's) judgment the fact that such forecasts were being made did not offer grounds for changing policy at this time. He thought the Committee should be prepared to accept the risks of a decline in real GNP in maintaining its present policy.

In concluding, Mr. Brimmer remarked that he had been interested in the Reserve Bank Presidents' comments today on the proposed commercial paper regulation. He would hope that in their

discussions with bankers the Presidents would not appear to be supporting the view that monetary restraint was excessive.

Mr. Sherrill said he was now convinced that the economic expansion was slowing, although perhaps not as rapidly as might be necessary. He considered the squeeze on corporate profits to be the most encouraging aspect of recent developments because of the effects that squeeze could be expected to have on businessmen's attitudes and on their plant and equipment expenditures. A key question was whether business attitudes would be sufficiently affected by the time of the next round of wage negotiations to produce substantial resistance to demands for large increases. If such demands were not resisted, inflationary conditions were likely to prevail for a long time.

Mr. Sherrill said he favored alternative A for the directive today. He thought it would be important to avoid giving any indication of easing, especially in light of the prospect for a relaxation of fiscal restraint.

Mr. Hickman remarked that the pace of the economy continued to moderate, with news of the third successive monthly decline in industrial production, a high rate of unemployment for two successive months, small declines in hours and earnings, and involuntary inventory accumulation. In addition, gains in personal income continued to diminish and the stock market remained weak. All of that indicated that economic developments were unfolding as previous forecasts

had suggested. True, the comprehensive price indicators were still rising at unacceptable rates, as they frequently did early in business contractions. The Committee's goal was to moderate the rates of increase in prices; since most price aggregates were lagging economic indicators, the economy would probably be in an advanced stage of contraction if the Committee held to its present policy course until the major price series turned down.

For a long time, Mr. Hickman said, he had been urging the Committee to adopt a slightly less restrictive monetary policy that could be maintained for as long as necessary to contain inflation and inflationary expectations without inducing a severe contraction in economic activity. The need for continuing some degree of restraint in the present situation was obvious; the exact degree of restraint remained an open question. His own view was that present policy was excessively restrictive and would eventually lead to a large shift towards ease. He was aware that even a minor move in policy now carried the risk of setting up adverse inflationary expectations, but he felt that the risk was worth taking, especially if the Committee did not validate those expectations with a drastic shift toward ease later on.

Mr. Hickman continued to feel that there was no justification for no growth or declines in the reserve aggregates and the money supply, particularly since the System appeared to have closed off all but the most costly nondeposit sources of funds

to banks. Therefore, he urged that the Committee move to a policy position of moderate restraint which could be maintained for a long period of time, and that it promote moderate growth in the bank credit proxy and reserve measures during December.

Mr. Hickman also felt that the System should go on record as opposing a further tightening of monetary policy to offset the inappropriate easing of fiscal policy that clearly was in the making. Since late 1965 the Federal Reserve System continually had to design monetary policy around stop-go fiscal policy. It was time now for the System to do what it could to promote an optimal mix of monetary and fiscal policies. If the Committee stayed on the present course much longer, he predicted that there would be both an unbalanced Federal budget and excessive monetary ease--as well as runaway price inflation--by next fall. Therefore, he favored alternative B of the staff's draft directives.

Mr. Hickman said he would welcome the application of the Board's proposals on commercial paper in December and would not change the rate ceiling on large-denomination CD's at this time. On the other hand, he would seek to provide for the banks' liquidity problems in a modest way through open market operations, a course which seemed to him to be implied by alternative B.

Mr Bopp commented that financial markets were clearly registering doubt about the Committee's ability and willingness to maintain the restraint necessary to stop inflation. Further evidence of that view was found in the results of the Philadelphia Bank's annual survey of corporate treasurers. That was a survey of financial officers of the 500 largest manufacturing and 150 largest nonmanufacturing corporations. Sixty-four per cent had responded. It was perhaps not surprising that they expected a 7 per cent growth in their plant and equipment expenditures in 1970; that was about in line with results in other surveys but nevertheless was too high for comfort. What was surprising, however, were the profit expectations. They were much more optimistic than any he had heard discussed; in fact, they seemed unrealistically high. But even when he discounted the magnitude, he found the attitudes underlying the projections disheartening. The treasurers indicated that they expected to be able to pass higher prices along to their customers in 1970. Given that view, it was questionable how willing corporations would be to resist demands for large wage increases.

Additional support for the view that expectations were still stubbornly bullish came from the Bank's November business outlook survey, Mr. Bopp continued. For the first time in a number of months, the October survey had indicated a decline in

the number of businessmen who were bearish about the six-month outlook. In November, again, the number of bears had declined. The declines were small and it was too soon to conclude there had been a reversal of the trend. But they were another indication that businessmen looked for only a mild and short slowdown and for renewed inflationary pressures.

Mr. Bopp did not believe inflation could be brought under control until those kinds of expectations were changed. And, whereas he had been hopeful for some time that that could be done without considerable disruption of the economy, he was now doubtful. A policy of restraint severe enough and held long enough to shift expectations might prove too much to avoid a recession. On the other hand, if the Committee were to ease visibly now, he felt certain that inflationary forces would be released which would be even more difficult to cope with than those the Committee now confronted. He failed to see what the Committee could do now that would not make for difficult times ahead.

In retrospect, Mr. Bopp said, historians might well decide that the Committee had made a mistake in this current period. If they simply correlated policy actions with economic turning points, they might conclude that the Committee had overstayed the boom. And with the benefit of hindsight, they might conclude that the Committee could have eased without provoking renewed inflation.

No one could say what would have happened under a policy that was not followed. However, it was his conclusion that whereas a price might have to be paid for continued severe restraint, a still greater price would have to be paid for moving away from that restraint now. Of course, his judgment had been wrong before and it could be wrong again.

Mr. Bopp regarded alternative A and a policy of no change as appropriate for the next three weeks. If the projections for December under a no-change policy were right, changes in the aggregates for the fourth quarter would be about where he thought they should be--less restrictive than in the third quarter but still well below their normal long-run growth trends.

With respect to the proposed regulation of commercial paper, Mr. Bopp said he too would recommend that the effective date be deferred. Alternatively, the regulation might be made effective gradually over the course of, say, three or four months. Gradual implementation would permit banks to make an orderly adjustment to the new regulation instead of compelling them to turn to the discount window. Like Mr. Morris, he would urge strongly that there be equal treatment of subsidiaries and holding companies despite the legal problems that might have to be resolved. It was difficult to justify the regulation of activities that had always been considered to be exempt and it was also hard on the institutions that suddenly found themselves to be subject to the regulation.

He therefore disagreed with Mr. Swan concerning the desirability of delaying the announcement; he (Mr. Bopp) would prefer to announce the new regulation soon.

Mr. Bopp added that it would be helpful to the Federal Reserve Bank Presidents if they were given more advance information on regulatory actions taken by the Board. When the Board took some unexpected action late in the day, the Presidents--particularly those located in the East--found themselves at a disadvantage and sometimes learned about the action through the newspapers. The interests of the whole Federal Reserve System would be served if, whenever possible, the Board avoided acting so suddenly that the Presidents could not be given adequate advance information.

Mr. Kimbrel reported that economic and financial developments in the Sixth District continued to parallel those for the country as a whole. District employment showed little change in October, although manufacturing workers put in a longer workweek. With October retail sales maintaining their sluggish pace, retail and wholesale prices pushing upward, and personal income growing at a reduced rate, the consumer sector of the economy was continuing to show less momentum. District auto sales, which generally seemed to show more strength than national sales, picked up slightly in October. However, sales were below the year-ago level--a condition that had continued since July. Bank credit had declined in the Sixth District during the first weeks of

November, primarily reflecting a slowdown in lending activity at the large commercial banks. Lower production and prices indicated sharply reduced income for row-crop farmers.

The behavior of the economy depicted by the latest statistics suggested to Mr. Kimbrel that the time had not yet come to move toward a less restrictive policy. Nevertheless, he had to confess that he was troubled by the possibility that the System might be progressively tightening instead of merely maintaining a restrictive policy. It appeared to him that the biting edge of policy for the banking system had become the administration of Regulation Q rather than the traditional availability of reserves and money market conditions.

Mr. Kimbrel said it could, of course, be shown that, because of the use of Euro-dollars and other nondeposit sources of funds, the impact of monetary restraint upon the banks had been far less than seemed to be indicated by the steady decline in time deposits which had been going on for almost a year. For much the same reasons, it could be argued that the declining trend in bank credit overstated the decline in credit made available to the economy. Nevertheless, those trends reflected important structural shifts--shifts which had been induced by regulation rather than by market forces. In seeking to prevent market forces from producing what were considered to be undesirable structural shifts,

other changes had occurred that were not anticipated. He was persuaded that the majority of bankers with whom he talked thought that in the process System policy was becoming more and more restrictive.

Recently, Mr Kimbrel continued, rearguard actions that had been necessary to plug up the loopholes suggested that there had been effects that had not been anticipated. He had no doubt that the ingenuity of bankers had by no means been exhausted and that rearguard actions would be necessary in the future. The recent experience was typical of what generally occurred when direct controls were imposed.

Mr Kimbrel observed that Sixth District bankers felt there was some inequity in the regulation of commercial paper issued by holding companies as contrasted to that issued by bank subsidiaries. He urgently hoped the Board could reconcile that apparent inequity before a final announcement of the regulation. While he had some reservations about the desirability of implementing the regulation, they would be reduced if the System simultaneously seized the opportunity to grant banks some latitude by raising Regulation Q ceilings, particularly for the larger accounts.

With respect to policy, Mr Kimbrel said he would favor "maintaining the prevailing firm conditions in money and short-term markets" as called for in alternative A.

Mr. Francis commented that, following the moderation of monetary expansion in the first half of this year, growth of total spending on goods and services had very likely, with a normal lag, declined in the last few months. The decline had been as rapid as one could reasonably expect and as rapid as was desirable. Recent monthly statistics showed such evidence of slowing. Personal income in September and October grew at only half the rate of the previous year. Unemployment had moved up somewhat. Industrial production had declined in the last three months, after increasing 5 per cent in the previous year. Housing starts had fallen. Retail sales had been about unchanged since last spring and, in real terms, had declined.

Mr. Francis remarked that monetary restraint had been severely intensified beginning in early summer. Since June member bank reserves had declined at an 8 per cent annual rate, following a small increase earlier in the year. Both the monetary base and the money stock had not grown at all, after rising at about a 5 per cent rate in the first five months of the year. Those developments would in all probability have further marked depressing effects on spending in the near future, allowing for normal lags between monetary actions and their effects.

With respect to the policy of the Committee for the near future, Mr. Francis said, the St. Louis Reserve Bank's studies continued to show that in every additional month the Committee

continued to permit no increase in the money supply it was increasing the probable decline of real product in 1970 and the probable increase of unemployment to levels which were unnecessary and undesirable. He thought it would be a mistake to follow a policy which would force a prolonged decline of real product. The zero rate of monetary expansion from early June to date, if followed by a 3 per cent growth rate now, would most likely give approximate stagnation of real product in 1970 and a 5 per cent unemployment rate in the third quarter. If the zero rate of money growth were continued through March, there would most likely be a significant decline of real product in the third quarter of 1970 and a 5.5 per cent unemployment rate. The benefits of the more restrictive stance in reducing inflation would not be great, since over-all prices were likely still to be rising at relatively rapid rates in the third quarter in either case.

In Mr. Francis' judgment, the Committee should avoid the course which was more likely to cause real product to decline at an annual rate of more than 3 per cent and the unemployment rate to rise at a rate above 5 per cent in the third quarter of next year. He believed the Committee should immediately start to get some increase in the money stock. At the same time, it should resolve not to permit the rate of increase to jump to 7 per cent, as happened at the beginning of 1967 following nine months of no increase. He would favor alternative B of the draft directives

Referring to the proposals for limiting bank access to the commercial paper market, Mr. Francis said it seemed to him that the thrust of Regulation Q had already relieved the commercial banks of much of their outstanding large-denomination CD's and was now in the process of doing about the same thing to time deposits other than such CD's. From July to December of 1968, time deposits less large-denomination CD's grew at an annual rate of about 14 per cent. From December 1968 through June 1969, time deposits less large-denomination CD's grew at an annual rate of 5 per cent. From June through the end of October, those time deposits had been declining at a 5 per cent rate. In the last six weeks, the rate of decline increased to 6 per cent. In absolute terms, the contraction in the last six weeks was $1.2 billion, about four times the dollar decline of large-denomination CD's over the same period. It seemed to him that Regulation Q was serving to minimize the relative position of banks within the over-all framework of financial institutions for reasons that had never been visible to him. He hoped that the Board would drop its proposal to regulate bank-related commercial paper and instead adjust Regulation Q ceilings across the board to permit banks to compete for funds.

Mr. Robertson made the following statement:

> I can be quite brief this morning because I believe the issues before the Committee today can be put fairly simply. The evidence suggests that restrictive policies are slowing the growth of the real economy, but the legacies of past excesses and deeply imbedded inflationary

attitudes are still keeping prices and wages rising at a rapid clip. Partly because of the resultant demands for more dollars, credit demands are staying strong, and we are living through another interval of simultaneous increases in both interest rates and monetary aggregates that reflect these influences.

Given the past and potential damage of inflation to our economy, I believe we must persist in our general posture of restraint until we can be more sure than we are today that we are on the track back to relative price stability. On the other hand, given the limitations on what monetary policy can do and the strong pressures already evident on our financial markets and institutions, I would not want open market operations to apply any further squeeze on reserves or money market conditions at this juncture.

With these considerations in mind, I would vote in favor of alternative A as drafted by the staff.

In the same breath, let me say that I think we may be very close to the time when we should ease off slightly. In fact, we may be so close that I would feel more comfortable if we were to see some continuing modest growth in the money supply during the fourth quarter to somewhere around the October-November average. However, to achieve that might mean that money market conditions would have to be kept on the easier side of those associated with alternative A in the blue book or slightly easier, and I am not sure that that would be appropriate in view of the absence of sufficient evidence that the inflationary expectations of our business leaders and the general public have been dampened--as yet. Consequently, in my view we should continue our present course for a few weeks longer, always being aware of the risks we are taking and keeping alert to any signs that might indicate we have gone far enough or too far.

If our policy prescription succeeds, credit demands will slacken; and if they do we must avoid holding up market rates, regardless of how we word the directive. If demands slacken, money market conditions should ease, but not so much as to set in train a resurgence of inflationary forces.

Chairman Martin said he agreed in general with the views expressed today by Messrs. Bopp and Sherrill. After talking with

a number of corporate treasurers and labor people during a three-day visit to New York last week, he had reached the conclusion that there was no way out of the present situation that would not involve serious difficulties. The problem for the System was to find the policy course that would result in the fewest difficulties.

The Chairman agreed with Mr. Morris that there recently had been a suggestion of panic in financial markets. The atmosphere in the stock market community was highly disturbed. The market value of bonds in the portfolios of banks had depreciated tremendously, and in some instances banks could not sell bonds they held at any price. There was little point in asking why financial institutions had got into their present situation; the fact was that they had. In his judgment there was no feasible means for giving relief to those whose positions were over-extended. In particular, he did not think a slight easing of monetary policy would be helpful.

Chairman Martin said he thought that both Mr. Axilrod and Mr. Keir had made excellent presentations today and that the Committee had focused in the go-around on the key problems facing monetary policy. He would hope that all concerned would continue to study those problems, including the question of the proposed regulation of bank-related commercial paper. Like the other voting members, he favored alternative A for the second paragraph of the directive. He understood that Mr. Holland, in consultation with other staff members, had worked out possible means for dealing

with the problems in the draft of the first paragraph that Messrs. Coldwell and Daane had mentioned.

Mr. Holland noted that Mr. Coldwell had suggested amplifying the statement on interest rates to take account of the role played by large Treasury bill issues in the recent sharp advance, and Mr Daane had suggested the addition of a reference to the outlook for fiscal policy. Both of those proposals, as well as a staff suggestion for also adding a reference to foreign official sales of bills, might be accommodated by revising the sentence on interest rates to read as follows: "Most market interest rates have again been advancing in recent weeks, in many cases reaching new highs as a result of demand pressures, including heavy Treasury and foreign official bill sales, and a reversal of earlier market expectations partly stemming from growing concern about the outlook for fiscal policy."

There was general agreement that such a revision in the draft language would be desirable.

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

The information reviewed at this meeting indicates that real economic activity has expanded only moderately in recent quarters and that a further slowing of growth appears to be in process. Prices and costs, however, are continuing to rise at a rapid pace. Most market

interest rates have again been advancing in recent weeks, in many cases reaching new highs as a result of demand pressures, including heavy Treasury and foreign official bill sales, and a reversal of earlier market expectations partly stemming from growing concern about the outlook for fiscal policy. In October bank credit declined on average and the money supply changed little, but both appear to be increasing relatively rapidly in November. Recently the net contraction of outstanding large-denomination CD's has slowed markedly, apparently reflecting mainly an increase in foreign official time deposits. However, flows of consumer-type time and savings funds at banks and nonbank thrift institutions have remained weak. In the third quarter a small surplus in U.S. foreign trade re-emerged, but there was another very large deficit in the over-all balance of payments on the liquidity basis and the official settlements balance, which had been in surplus earlier, was also in deficit. More recently, return flows out of the German mark have apparently contributed to some short-run improvement in the U.S. payments position. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the reduction of inflationary pressures, with a view to encouraging sustainable economic growth and attaining reasonable equilibrium in the country's balance of payments.

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

Chairman Martin noted that the Secretariat had distributed a memorandum dated November 17, 1969, and entitled "Alternative possible procedures for release of FOMC minutes for years after 1961."[1/] He asked Mr. Holland to comment.

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

Mr. Holland observed that the Committee's minutes through the year 1961 had been made available to the public in full by transfer to the National Archives. The memorandum suggested that the Committee consider announcing the release of its minutes for the years 1962-4, and perhaps 1965, around the turn of the year The bulk of the memorandum was concerned with possible means for dealing with problems in the minutes for years after 1961 in connection with the discussions of foreign currency operations that they contained.

As the memorandum noted, Mr. Holland continued, the foreign currency discussions included some passages, such as comments on the internal affairs of particular foreign central banks and Governments and on the views of particular foreign officials, which it might be desirable to withhold from publication for a time. Two possible procedures for dealing with such problems were described. One alternative would be to delete the sensitive passages when the minutes were initially transmitted to Archives, on the understanding that they would be reviewed from time to time to determine whether they had become sufficiently nonsensitive to permit release. The other alternative would be to withhold the foreign currency discussions in their entirety at this time.

Mr. Holland noted that the staffs of both the Board and the New York Bank had undertaken reviews of the minutes in question-covering the domestic as well as the foreign currency discussions--

and hoped to be able to give the Committee a detailed report regarding the passages that might be considered too sensitive to release now. It was not clear, however, how soon it would be possible to complete that work. The Secretariat therefore recommended that the Committee follow a conditional approach; specifically, that the first alternative be approved on the condition that a reasonable degree of agreement regarding the specific passages to be recommended for deletion could be reached at the staff level and reported to the Committee relatively soon; and that the second alternative be approved if it became clear that that was not possible.

Chairman Martin commented that the public reaction to the Committee's release of its minutes through 1961 had been quite favorable. In his opinion, it would be highly desirable to release Committee minutes covering additional years as rapidly as possible and with as full disclosure as feasible. The trend of the times--both here and abroad--was toward fuller and fuller disclosure of the activities of governmental agencies. While there might be some passages in the foreign currency discussions that should be withheld, he would not expect the problems of sensitivity in the minutes through 1965 to be of very great significance in view of the time that had already elapsed.

Mr. Hayes said he did not think there would be any particular problems in releasing the parts of the minutes dealing with domestic operations, although he would want to await the completion of the

staff's review of that material before reaching a final conclusion. However, he had serious reservations about the desirability of publishing the foreign currency discussions in full. At the same time, he thought a process of selective deletion might raise more problems than it would resolve, by damaging the continuity of the minutes and perhaps by leading to speculation about the nature of the omitted material It might be possible, however, simultaneously to avoid the problems of sensitivity and to preserve continuity by paraphrasing affected passages. If that were done it should, of course, be publicly acknowledged.

Mr. Daane asked whether the selective deletion procedure would necessarily involve blank spaces on the affected pages, or whether it would be possible to present a continuous text. If the former, he would agree with Mr. Hayes that the procedure would raise more questions than it would resolve.

Mr. Holland replied that that was a question the Committee presumably would want to decide. One possibility would be to retype the pages involved, omitting sensitive passages.

Mr. Mitchell commented that, whatever the procedure followed, it should be explained when the minutes were released.

Mr. Brimmer remarked that he thought there was considerable merit in Mr. Hayes' suggestion for paraphrasing sensitive passages In preparing for today's discussion he had talked with two historians--one concerned with editing diplomatic papers and one with

preparing testimony before Congressional committees for publication. They both had noted that they followed the practice of paraphrasing selected passages for security reasons. The fact that such paraphrasing was done was acknowledged in the publications, but the specific passages involved were not identified. If the Committee were to follow a similar procedure it would be possible to release the domestic and foreign parts of the minutes together. Perhaps it would be desirable to get the help of a historian in the work.

Mr. Galusha commented that such a procedure had an Orwellian flavor that he would find disturbing. Clearly, the question of who did the editing would be critical. It was not hard to imagine a process in which the minutes would be emasculated.

Chairman Martin expressed the view that it would be best to go as far as possible in releasing the minutes in exactly the form in which they were approved.

Mr. Francis said he agreed strongly with the Chairman's view, and Mr. Hickman also concurred.

Mr. Robertson remarked that it might be possible to release the foreign currency discussions in full if a longer lag were employed for them than for the discussions of domestic operations.

Chairman Martin noted that there would already be a considerable lag if the minutes through 1965 were released in early 1970.

Mr. Daane commented that he would favor releasing as much of the minutes material as feasible. However, he recalled that the

minutes contained passages that could be embarrassing to some foreign officials who were still in office. Accordingly, he would be reluctant at this point to agree that they should be made available in full.

In reply to a question by Mr. Hayes, Mr. Coombs said he also would have reservations about publishing the foreign currency discussions in full In particular, the discussions at the Basle meetings, as well as those involved in various kinds of negotiations, had been considered by the participants to be confidential and had proceeded on the assumption that views expressed would not be publicly revealed. From his review of the 1962 minutes he had concluded that sensitive passages could be omitted without damaging the continuity. In subsequent years, however, paraphrasing might often be desirable to preserve the sense of the discussion.

Mr. Bopp said he believed it would be useful to employ a device mentioned in the Secretariat's memorandum--asking the foreign parties involved in particular potentially sensitive passages whether they would have any objections to publication of those passages by the System--in order to reduce as far as possible the number of passages withheld. If it was found necessary to engage in paraphrasing, he thought the Committee should seriously consider obtaining the services of a historian whose objectivity would be widely recognized.

Mr Sherrill remarked that he found it difficult to form any judgment on the desirability of withholding material without having at hand specific examples of passages that might be considered sensitive.

Chairman Martin suggested that the staff be asked to continue its review of the minutes through 1965 and to report to the Committee as soon as possible concerning the passages that might be considered sensitive. He would expect the review of the parts of the minutes relating to domestic operations to proceed quickly. The problems were greater in the foreign currency area, but hopefully the staff would be able to make at least a partial report on that area before the next meeting. In the interim, the Committee members might want to read parts of the foreign currency discussions themselves. The more he engaged in such reading, the fewer the passages he thought might legitimately be described as "sensitive." To undertake to paraphrase such passages might simply compound the problem. However, the staff might be asked to give examples of alternative treatments of sensitive passages, including both deletion and paraphrasing.

Mr Swan said it would be helpful to have such examples in advance of the full review of the minutes in question.

The Chairman agreed. He added that in the future the Committee was likely to find itself under considerably more pressure for disclosure--from committees of Congress and others--than it had

been in the past. It would be far better, he thought, for the Committee to act on its own rather than in response to pressure. From his experience he did not think it would be easy to convince Congressional committees that certain material had to be withheld because it concerned the System's foreign partners.

The Chairman then asked whether there would be any objections to having the staff proceed on the basis described and planning to continue the discussion at the next meeting of the Committee. No objections were raised.

Chairman Martin then noted that a memorandum had been distributed from Messrs. Holland, Holmes, and Hackley, dated November 12, 1969, and entitled "Request for access to Committee records."[1/] He asked Mr. Holland to comment

Mr. Holland observed that the memorandum was concerned with an appeal from staff determinations denying access to certain records of the Committee that had been filed under section 271.6 of the Committee's Rules Regarding the Availability of Information by Mr. John F. Hahn, a member of one of the Nader task forces. In a letter dated September 19, 1969, Mr Hahn requested review of determinations denying public access to (1) staff memoranda, briefings, or reports for any given Committee meeting in 1969; (2) minutes of discussion at each meeting in 1968 and 1969; and

---

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

(3) a list of all transactions with dealers, on a transactions-by-transactions basis, from 1960 to the present. It was recommended in the memorandum that the Committee affirm staff determinations denying access to the first two categories of records mentioned, but indicate that access would be provided to information regarding daily data on amounts, kinds, and prices with respect to transactions in securities without identification of dealers. The considerations underlying that recommendation were set forth in an attached memorandum from Mr. Noble of the Board's Legal Division, which also transmitted a draft of a letter to Mr. Hahn incorporating the suggested rulings.

With respect to the third category of records requested, Mr. Holland continued, the Committee would recall that on June 20, 1967, it had approved release to any person on request of documents held at the New York Bank containing information described in a list dated May 17, 1967, with time lags as indicated. At the same time it had authorized a staff committee consisting of the General Counsel, Account Manager, and Secretary to release documents containing similar information, with the understanding that the staff committee would refer to the Committee any requests for materially different information. It was recommended in the memorandum that if the Committee approved the proposed reply to Mr. Hahn, the staff also be authorized to respond affirmatively to similar requests for information with respect to daily transactions in securities entered

into by the New York Bank, including the amounts, kinds, and prices of securities, but without identification of individual dealers and with a reasonable time lag.

Mr. Daane noted that it was proposed to charge for the work of supplying the data under discussion at the rate of $5 per hour of search time, as specified in the Committee's Rules. He asked whether that charge would cover the actual costs likely to be incurred.

Mr. Holmes replied that the indicated charge probably would not quite cover actual costs. However, $5 per hour appeared to be a standard charge and seemed reasonable to him.

After further discussion, the Committee concurred in the staff's two recommendations.

By unanimous vote, the following letter was approved:

Mr. John F. Hahn,
3700 Bagley, Apt. 305,
Los Angeles, California. 90034

Dear Mr. Hahn:

In response to your letter of September 19, 1969, and pursuant to section 271.6 of its Rules Regarding Availability of Information, the Federal Open Market Committee has reviewed your request for access to certain Committee records. Your letter requested such review following an earlier exchange of correspondence between you and Charles Molony, and was prompted by Mr. Molony's indication that certain Committee records are not available for public inspection.

The first two items in your appeal (questions 5 and 6 of your inquiry) involve staff memoranda, briefings, and reports in connection with any Committee meeting in 1969 and minutes of discussion at such meetings in 1968 and 1969. With respect to these records, the Committee has sustained the determination reported to you by Mr. Molony. The Committee has adopted procedures intended to inform the public of its actions as fully and as promptly as possible without compromising the effectiveness of those actions. To that end, an extensive summary record of policy actions is published by the Committee, and action minutes are also available for public inspection, with deferrals of generally about 90 days. Disclosure of the materials which you request would unnecessarily inhibit the free discussion essential to a reasoned group judgment, and would also reveal actions considered but deferred or not taken, with possible adverse effects on both public and private interests. For these reasons, the Committee relies upon the exemption from public disclosure provided by 5 U.S.C. 552(b)(5), and declines to make such material available for public inspection.

Your letter also requests a review of the denial of access to data regarding specific securities transactions with individual dealers. You explain that your interest is in determining the amount of profit made by dealers on such transactions, and indicate that, at this time at least, you are not interested in data with respect to any particular dealer. This casts a somewhat different light on the issue, since it was previously understood that you were requesting access to the records of transactions with individual and specified dealers. The Committee would sustain Mr. Molony's ruling with respect to transactions revealing the identity of individual dealers, but information as to the prices at which securities were purchased and sold in the conduct of System open market operations would be provided, without identification of individual dealers and subject to a reasonable time lag. We should note, however, that this information will in fact shed little light on profits made by dealers on transactions with the Federal Reserve.

It should also be noted that this material, even for a relatively brief time span, would be voluminous, and its assembly would be very time-consuming for our staff and consequently costly to you under the fees chargeable for search time. A compilation very similar to that in which you express an interest was prepared several years ago in response to a Congressional inquiry. While this particular compilation is

not current, it could be provided fairly promptly and at little cost; you might therefore wish to inspect it as a first step and make a judgment in that light as to whether, and to what extent, you wish to inquire further into the matter.

Secretary's note: The letter was transmitted over Mr. Holland's signature later in the day.

By unanimous vote, the Committee approved the release with a reasonable time lag to any person on request of certain documents held at the Federal Reserve Bank of New York, described in a staff memorandum of November 12, 1969, in supplementation of the list of such documents that had been approved for release on June 20, 1967.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, December 16, 1969, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

CONFIDENTIAL (FR) November 24, 1969

Drafts of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its meeting on November 25, 1969

FIRST PARAGRAPH

The information reviewed at this meeting indicates that real economic activity has expanded only moderately in recent quarters and that a further slowing of growth appears to be in process. Prices and costs, however, are continuing to rise at a rapid pace. Most market interest rates have again been advancing in recent weeks, in many cases reaching new highs, as a result of demand pressures and a reversal of earlier market expectations. In October bank credit declined on average and the money supply changed little, but both appear to be increasing relatively rapidly in November. Recently the net contraction of outstanding large-denomination CD's has slowed markedly, apparently reflecting mainly an increase in foreign official time deposits. However, flows of consumer-type time and savings funds at banks and nonbank thrift institutions have remained weak. In the third quarter a small surplus in U.S. foreign trade re-emerged, but there was another very large deficit in the over-all balance of payments on the liquidity basis and the official settlements balance, which had been in surplus earlier, was also in deficit. More recently, return flows out of the German mark have apparently contributed to some short-run improvement in the U.S. payments position. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the reduction of inflationary pressures, with a view to encouraging sustainable economic growth and attaining reasonable equilibrium in the country's balance of payments.

SECOND PARAGRAPH

Alternative A

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

Alternative B

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a

view to achieving slightly less firm conditions in money and short-term credit markets; provided, however, that operations shall be modified if bank credit appears to be deviating significantly from current projections or if pressures arise in connection with possible bank regulatory changes.