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, May 23, 1967, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Brimmer
Mr. Daane
Mr. Francis
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Scanlon
Mr. Sherrill
Mr. Swan
Mr. Wayne
Mr. Treiber, Alternate for Mr. Hayes

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

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

Mr. Holland, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Hexter, Assistant General Counsel
Mr. Brill, Economist
Messrs. Baughman, Hersey, Jones, Koch, Partee, and Solomon, Associate Economists
Mr. Holmes, Manager, System Open Market Account

Mr. Fauver, Assistant to the Board of Governors
Mr. O'Connell, Assistant General Counsel, Legal Division, Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Reynolds, Adviser, Division of International Finance, Board of Governors
Miss Eaton, General Assistant, Office of the Secretary, Board of Governors

Mr. Kimbrel, First Vice President of the Federal Reserve Bank of Atlanta
Messrs. Eisenmenger, Eastburn, Mann, Parthemos, Brandt, Tow, and Green, Vice Presidents of the Federal Reserve Banks of Boston, Philadelphia, Cleveland, Richmond, Atlanta, Kansas City, and Dallas, respectively
Messrs. Fousek, MacLaury, and Olin, Assistant Vice Presidents of the Federal Reserve Banks of New York, New York, and Minneapolis, respectively
Mr. Lynn, Director of Research, Federal Reserve Bank of San Francisco
Mr. Geng, Manager, Securities Department, Federal Reserve Bank of New York

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 2, 1967, were approved.

By unanimous vote, the action taken by members of the Federal Open Market Committee on May 12, 1967, amending paragraphs 1A and 2 of the authorization for System foreign currency operations, effective May 17, 1967, to read as follows, was ratified:

1A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, and with the Bank for International Settlements:

Austrian schillings
Belgian francs
Canadian dollars
Danish kroner
Pounds sterling
French francs
German marks
Italian lire

Japanese yen
Mexican pesos
Netherlands guilders
Norwegian kroner
Swedish kronor
Swiss francs

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

Foreign bank	Amount of arrangement (millions of dollars equivalent)	Maximum period of arrangement (months)
Austrian National Bank	100	12
National Bank of Belgium	150	12
Bank of Canada	500	12
National Bank of Denmark	100	12
Bank of England	1,350	12
Bank of France	100	3
German Federal Bank	400	6
Bank of Italy	600	12
Bank of Japan	450	12
Bank of Mexico	130	12
Netherlands Bank	150	3
Bank of Norway	100	12
Bank of Sweden	100	12
Swiss National Bank	200	6
Bank for International Settlements		
System drawings in Swiss francs	200	6
System drawings in authorized European currencies other than Swiss francs	200	6

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 May 2 through May 17, 1967, and a supplemental report for May 18 through 22, 1967. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. MacLaury reported there had been no change in the Treasury gold stock this week nor had there been any change since February. As recently as yesterday it had appeared that no reduction would be required for the next few weeks, but that was no longer certain. Various developments had resulted in a sharp increase in gold market activity. Turnover in the London market, which normally averaged about $5 million a day, had risen to near-record levels in recent days: $20 million on Friday, roughly $20 million again yesterday, and $30 million today. The gold pool had suffered substantial losses in the last three days, totaling about $65 million. The heightened activity reflected a combination of factors. The political disturbances in Hong Kong, and more particularly the increased threat of war in the Middle East, were important. The U.S. Treasury's decision last Thursday to suspend sales of silver for export added a further element of uncertainty, especially since it followed on the heels of last month's discussion of U.S. gold policy. The European press had played up the possibility that what had been done with silver could also be done with gold, although on any reasoned basis it was clear that the two situations were not parallel.

As the Committee knew, Mr. MacLaury continued, only the fact that South Africa had been running down its reserves (by $125 million in gold since the end of 1966) had kept the pool deficit in a manageable range this year. At the moment there was only $40 million available to the pool without further discussion among the members, and an additional $50 million could become available after consultation. How quickly that margin could disappear was indicated by the pool's losses in the last few days.

In the exchange markets, Mr. MacLaury said, the most immediately troublesome development had been the weakening of sterling. The momentum of recovery that had been so evident during the first few months of the year ended rather abruptly this month, and for the past two weeks the Bank of England had had to extend intermittent--and at times sizable--support to hold the rate. Again, a combination of factors was responsible: first, the one-half point reduction in the British Bank rate on May 4 to 5-1/2 per cent, together with the rise in Euro-dollar rates, had reduced the relative pull of London rates on foreign funds; more important, the disappointing April trade figures, released May 11, triggered the first sharp sell-off of sterling in many months; and finally, of course de Gaulle's press conference a week ago, in which he painted in starkly negative terms the hurdles Britain would have to surmount to attain membership in the Common Market, added a further blow. Those developments, together with the political disturbances just mentioned in connection with gold, put sterling under substantial pressure. For the month to date, the Bank of England had lost, net, well over $100 million in market support operations. At the beginning of the month the British had repaid the final $150 million of sterling balance credits, as required by the rise in such balances during the preceding month. In addition, the Chancellor announced in Parliament early this month--before the reserve losses--that the U.K. would prepay $485 million to the International Monetary Fund and Switzerland on May 25. It was still too early to forecast how the month as a whole would turn out; the British took in $22 million yesterday and today the sterling market had been quiet. If the line were drawn now, however, British reserves would be down nearly $800 million from the end of last month as a result of its market support operations and debt repayments. Clearly, any such drop--even though more than half explained by the repayments to the International Monetary Fund and Switzerland--would have a seriously damaging impact on the market. Thus, the possibility of bringing into the reserves the remaining British portfolio was being actively discussed, as was the possible necessity of resorting once again to short-term assistance.

On the continent, Mr. MacLaury observed, the dollar had generally remained weak. A number of central banks had been taking in dollars. Early in the period the System utilized some $30 million equivalent of its Belgian franc balances under the fully-drawn portion of its swap arrangement with the Belgian National Bank to absorb an equal amount of funds taken in by that Bank. More recently, there had been a particularly heavy movement of dollars into Switzerland where the relative tightness of the money market had added to the inflows generated by political uncertainties and more recently by the pressures on sterling. Since May 10, the Swiss National Bank had taken in from the market well over $100 million, and, of course, it would be receiving some $80 million on Thursday from the British prepayment. Thus, the U.S. faced the prospect of finding ways to absorb close to $200 million from the Swiss. A gold sale undoubtedly would be part of the package, and it might well be that the System would have to reactivate its swap arrangement with them. Certainly, the outlook for the dollar over the summer months was not reassuring, and as Mr. Coombs had indicated at the last meeting, there was every likelihood that the System's swap network would have to be heavily relied upon.

Mr. MacLaury went on to say that Mr. Coombs originally had expected to wait until today to ask for the Committee's formal approval of the addition of the central banks of Denmark, Mexico, and Norway to the swap network. However, the developments mentioned in his message of May 12 transmitted by wire[1/] to Committee members made it seem desirable to request approval at that time. As indicated in that message, Denmark particularly wished to be able to announce its new swap arrangement on May 18 along with Norway, and Mexico preferred that its arrangement be announced at the same time. In Mr. Lang's conversations with the Venezuelans following the Committee's preceding meeting, they had indicated that they appreciated being kept informed on developments, but since there was no present prospect of Venezuela's moving toward Article VIII status in the near future they understood that the System would wish to proceed with the other countries involved With respect to the renewal of the swap arrangement with the Bank of France, the developments following the preceding meeting had been reported to the Committee in a memorandum from Mr. Coombs dated May 9, 1967.[2/] He (Mr. MacLaury) had little to add to the information in the memorandum, except to say that

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

2/ A copy of this memorandum, entitled "Swap arrangements with Common Market countries; discussions at Basle, May 6-7," has been placed in the Committee's files.

Mr. Coombs felt that the frank discussions with the European central bankers had done a lot to clear the air and to bring home the importance of the swap network to them as well as to the United States.[1/]

In that connection, Mr. Coombs had asked him to say that the firm stand the Committee had taken at its preceding meeting had been of great help to Messrs. Hayes and Coombs in their discussions with the Europeans.

Mr. Brimmer asked whether the operation of bringing the remaining British portfolio into their reserves would have any effect on the U.S. balance of payments.

In reply, Mr. MacLaury commented that the British portfolio no longer included any equities. They did hold a substantial volume of debt securities with maturities of over one year, particularly U.S. agency issues. If they liquidated those holdings or converted them into shorter-term issues the effect would be to increase the U.S. deficit. However, the British appeared to have adequate cash on hand, so even if they brought the portfolio into reserves they would not necessarily convert it immediately. The effects on the U.S. deficit might thus be spread over time.

Mr. Maisel asked whether there was any significance to the fact that the U.S. Treasury recently had redeemed bonds denominated

1/ A sentence has been deleted at this point for one of the reasons cited in the preface. The sentence reported a further comment on the subject under discussion.

in Belgian francs held by the Belgians in an amount--$30 million--equal to that involved in the System's current disbursements under the Belgian swap line.

Mr. MacLaury responded that the Treasury had accumulated $30 million in Belgian francs last fall, and since the Belgians had asked to have the bonds paid off at maturity the Treasury had used the francs to redeem them. It was simply coincidence that the System's subsequent use of the swap line had involved the same figure. He added that there was no reason at this stage to believe that the Belgians would not consider taking on additional bonds at a later date if that seemed appropriate.

Mr. Mitchell said he was disturbed by statements in Mr. Coombs' memorandum of May 9 to the effect, first, that there had been an agreement by the central bank governors of the Common Market that the Federal Reserve would have full opportunity to express its views before those central banks reached any new binding agreement, and secondly, that an agreement might be worked out under which all the swap agreements except that with the French would have a common maturity date at the end of the year. As he understood the matter, the Europeans had been interested in arranging common maturity dates to facilitate multilateral surveillance. Was it valid to infer that the System had given up its resistance to the efforts to put the network under surveillance by the Common Market countries, and was now willing to accept such surveillance at the end of each year? Or was that still a matter for negotiation?

Mr. MacLaury replied that the question of the kind of agreement that would be negotiated between the Common Market central banks and the System remained completely open. Mr. Mitchell's point regarding common year-end maturity dates was well taken, but perhaps equally important was the agreement by the Common Market central banks to abandon their efforts to present the System with a _fait accompli_. Those central banks, of course, had every right to discuss their swap lines with the System among themselves, but the fact was brought home to them that the System was disturbed by their action in taking a firm decision regarding those arrangements without consulting the Federal Reserve.

Secondly, Mr. MacLaury said, while it was probable that there would be a move toward a common maturity date--although the matter was still open--that move would involve not only the arrangements with the Common Market central banks but also those with the System's other partners in the network. If only the Common Market countries were involved, observers might conclude that the System had agreed to surveillance by them. But if the shift was more general such an impression was less likely to be created.

Mr. Mitchell then said he thought the Committee should discuss the matter further before the negotiations proceeded. It was possible that the System might already have traded away much of its potential for resisting surveillance by agreeing to negotiate about a common year-end maturity date. In any case, a discussion would give the Special Manager a full understanding of what the Committee would like to accomplish.

Mr. Daane agreed that such a discussion would be highly useful. He added that the Special Manager had been conscious of the problem Mr. Mitchell had noted. It was clear that avoiding a common maturity date would be preferable from the System's point of view, but it was important to recognize that the Common Market countries felt quite keenly on the matter of multilateral surveillance.

Chairman Martin proposed that the discussion Mr. Mitchell had suggested be put on the agenda for the next meeting of the Committee.

Mr. Wayne noted that he also had been disturbed by the suggestion that there be common maturity dates for the swap arrangements, although he would not necessarily question such a move. He thought it would be desirable to have a memorandum from Mr. Coombs in advance of the next meeting, commenting on the significance of common maturity dates and providing a fuller explanation of the implications of having the whole network on that basis rather than just the Common Market central banks.

Mr. Hickman observed that the Committee's interest in avoiding a common maturity date had been evident in the discussion at the preceding meeting.

Mr. Robertson noted that the question at issue then had concerned quarterly, rather than annual, common maturity dates.

Mr. Brimmer recalled a comment of Chairman Martin's at the preceding meeting, when he had been asked whether it was his feeling that the Committee should run the risk of having its swap arrangements brought under the surveillance of the Common Market. The Chairman had replied that it was not yet clear to him how serious that risk was, since much depended on the attitudes of the Germans and the Italians. In his (Mr. Brimmer's) judgment, it was understood at that time that the Committee would not automatically agree to negotiations with the Common Market on the basis of multilateral surveillance.

Chairman Martin concurred. He felt that the System had not tied its hands, and that the Committee should keep the matter under consideration. In his judgment Messrs. Hayes and Coombs had conducted the recent negotiations in an excellent manner.

By unanimous vote, the System open market transactions in foreign currencies during the period May 2 through 22, 1967, were approved, ratified, and confirmed.

Mr. MacLaury then noted that the $50 million supplementary standby swap arrangement with the National Bank of Belgium, originally negotiated in September 1966, would mature on June 30, 1967; and the full $150 million swap arrangement with the Netherlands Bank would mature on the same date. Both had terms of three months, and he recommended their renewals for additional terms of the same length. As noted in the preceding discussion, there might be a general move toward one-year terms in the System's swap arrangements but that, of course, had not yet been negotiated.

By unanimous vote, renewal for further periods of three months of the $50 million supplementary standby swap arrangement with the National Bank of Belgium, and the $150 million standby swap arrangement with the Netherlands Bank, both scheduled to mature on June 30, 1967, was approved.

Mr. MacLaury then noted that, as the Committee would recall, under the $100 million, twelve-month swap arrangement with the National Bank of Belgium that had been in effect before September 1966, it had been the established practice for both parties to make a $50 million drawing with a maturity of six months. That drawing would mature on June 22, 1967, and he recommended its renewal for a further period of six months. As he had indicated, the System now held in balance $20 million in Belgian francs, having utilized $30 million of the fully-drawn portion of the arrangement earlier this month.

> Renewal for a further period of six months of the $50 million drawing on the swap arrangement with the National Bank of Belgium, scheduled to mature June 22, 1967, was noted without objection.

Chairman Martin then invited Mr. Daane to report on developments at the meeting of the Deputies of the Group of Ten which he had attended last week.

Mr. Daane said that the Deputies had met in Paris for a day and a half on May 18 and 19. The sessions were largely devoted to further discussion of the unresolved technical issues relating to reserve asset creation that he had mentioned at the previous meeting of the Committee--namely, whether the new asset should be transferable directly or indirectly, whether it should involve pooled resources in the Fund or separate resources in the Fund or in a Fund affiliate, and whether repayment provisions should be attached to the asset. It was fair to say that some further progress had been made in narrowing the differences of view on those technical issues. His own judgment was that the remaining differences probably could be resolved on the issues of transferability and fund resources.

The issue of repayment provisions was the most difficult of the three because it went to the heart of the question of whether the new asset should be credit-like--which was the French view--or money-like, which the U.S. favored. From what he had gleaned outside the formal sessions, it appeared that the French were prepared to take a fairly hard position on that issue, and might drop out of the whole exercise unless they won agreement with their position.

The U.S. delegation had submitted two papers, Mr. Daane continued, of which one updated the illustrative Fund scheme for a new reserve unit. Realistically, however, the U.S. representatives did not see much chance for a new reserve unit to emerge from the discussions. The second U.S. paper not only updated the Fund's illustrative scheme for a drawing right but improved on the type of drawing right envisaged. That paper had been submitted during the course of the meeting and was not discussed.

Mr. Daane went on to say that on the fourth unresolved issue--that of decision-making--the Deputies had made no progress. Quite clearly that was a political issue which, he felt sure, would have to be resolved at a higher level. The Common Market countries wanted requirements calling for a majority of 85 per cent of votes in the Fund and a majority of creditor countries; and they would like to see Fund votes adjusted to give greater weight to their countries. The U.S. proposal involved a two-stage voting plan, which had been labelled the "band" proposal. It called for a scheme to go into effect if it won 90 per cent of the votes, and for a second vote to be held if the proportion favoring the scheme fell in the band between 75 and 90 per cent. In the second vote a majority of at least 75 per cent would be required to carry. The U.S. response to the insistence of the Common Market countries on an 85 per cent requirement was to narrow the band involved in its own proposal. As he had indicated, however, the question of decision-making was not likely to be resolved by the Deputies of the Group of Ten. It would have to go at least to the Ministers and Governors.

The technical issues would be considered further at a joint meeting of the Deputies with the Executive Directors of the Fund in Paris on June 19 - 21, Mr. Daane said. That presumably would be followed by a meeting of the Ministers and Governors of the Ten. Hopefully, at least the broad outlines of a plan would be presentable by the time of the meeting in Rio de Janiero in September.

Mr. Galusha asked whether Mr. Daane now felt somewhat less confident about the probable outcome of the discussions than he had at the last meeting of the Committee.

Mr. Daane replied that perhaps he was a little less confident than he had been earlier. The position taken by the French representatives seemed to be closely related to what their government was likely to be willing to accept, and there was no assurance that the other Common Market countries would be willing to go ahead without France. He supposed the key question concerned the attitude of Germany. But the matter lay in the political realm, where he could not offer an expert judgment.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering open market operations in U.S. Government securities and bankers' acceptances for the period May 2 through 17, 1967, and a supplemental report for May 18 through 22, 1967. Copies of both reports have been placed in the files of the Committee.

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

> Even keel considerations were the paramount factors guiding open market operations over much of the period since the Committee last met. While there were substantial movements in interest rates in response to basic market factors and shifting expectations, there was a generally comfortable tone in the money market with reserve availability a bit on the generous side.
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> At the time of the last meeting the books were open on the Treasury's May refunding, and, amid uncertain market conditions, the outcome was still in doubt. A small amount of purchases for Treasury investment accounts was made and the atmosphere gradually improved before the books closed on May 3. Although attrition was relatively high on the May and June maturities, the Treasury was able to achieve a significant amount of debt extension. Most importantly, holders of $1.3 billion of Government securities maturing in August elected to prerefund--an exchange larger than

many market participants had expected. In view of the Treasury's heavy cash needs in the second half of the calendar year it was indeed useful to reduce the size of the August refunding to routine proportions.

While dealers as a group did not take an excessively large position in the new issues, a few dealers had acquired sizable blocks of the five-year 4-3/4s. As a result, when prices of Government securities deteriorated again a few days after the books had closed, reflecting continuing pressures in the corporate and municipal markets, a booming stock market, and generally buoyant general business expectations, there were heavy professional offerings of intermediate-term Governments in the market. In this atmosphere Treasury investment accounts purchased about $240 million high-coupon issues maturing in 1971 to 1974. These purchases were helpful in reducing an overhang of securities in the market without interfering with basic market forces determining interest rates.

System purchases of coupon issues were deferred until two days after payment date for the issues offered in the refunding, when, as the written reports indicate, $101.6 million were purchased on a market go-around. Given the downward pressure on Treasury bill rates and the availability of intermediate- and longer-term Government securities, these operations were generally taken by the market in stride, without creating any exaggerated expectations about System interest rate intentions.

Over the next three weeks, as the blue book[1/] indicates, it looks as if the System will have to provide about $0.5 billion in reserves unless the Treasury should have to run its balance at the Reserve Banks down before mid-June. After mid-June the situation will be temporarily reversed. Market conditions at the moment would make it feasible to meet a significant proportion of these needs--perhaps half--through the purchase of coupon issues. The availability of coupon issues and the widespread demand for Treasury bills, noted earlier, are technical factors that tend to make such a pattern of

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

operations feasible. From a policy point of view, operations in coupon issues would make some marginal contribution to the flow of funds in longer-term markets by relieving the overhang of Government securities now in the market. There are risks, however, that an overly aggressive approach to the purchase of coupon issues would lead the market to believe that the System was attempting to establish a pattern of long-term rates. Creation of such an impression would, in my view, be unfortunate since it could lead to an avalanche of offerings to the System and since our operations to supply reserves--on current forecasts--would be, at least temporarily, reversed in mid-June. Thus a cautious approach appears called for. I would agree with the blue book that there might be only limited effects on market trends provided expectations do not get out of hand.

Current rate trends have been described in detail in the various written reports to the Committee. While the downgrading of some recent economic statistics has dampened somewhat the exuberant view of the economy that prevailed a few weeks ago, expectations are for a strong second half of the year. The weight of corporate and municipal financing continues apace--the June corporate calendar now appears likely to exceed the record March calendar, the demand for funds in the tax-exempt area continues to run high, and an announcement of $880 million FNMA participation certificates is expected momentarily by the market. The corporate calendar has been building for July and August with a growing volume of convertible debentures in the works, and the debt limit hearings have done nothing to allay market apprehension of major Treasury and Government agency needs, including PC's, in the new fiscal year. In fact, the proposals for modification of the 4-1/4 per cent interest rate ceiling had quite a depressing influence, particularly on the market for 5-10 year Treasury issues.

Long-term rates have, of course, moved significantly higher but further testing of the market is needed to see whether a trading range can be established. Short rates, in contrast, have generally moved lower with investors tending to hole up in the short maturities while market developments unfold. Banks have found it difficult to place CD's with maturities of a year or more, and rates in that area have moved close to 5 per cent. In yesterday's bill auction average rates of 3.49 and 3.69 per cent were established respectively on 3- and 6-month Treasury bills, down 28 and 22 basis points respectively from the auction preceding the last meeting.

The impact of the massive corporate debt restructuring so far this year on the demand for bank credit is still not clear. Many banks report a continuous business loan demand, but it is hard to determine how much this reflects a precautionary firming up of commitments and how much an early need for cash on the barrel head. As you know, bank credit in May appears to be expanding only moderately on average, and despite the final round of tax acceleration, the June credit proxy forecast is for only a 5 per cent annual rate of growth. Perhaps the forecast is too conservative, but it appears to be a modest growth rate in light of the over-all demand for credit that is apparent in financial markets.

Mr. Hickman asked whether the Manager foresaw a tapering off in corporate and municipal bond offerings over the summer months.

Mr. Holmes replied that it was very hard to judge when offerings might taper off. Although some issues had been postponed recently, the corporate calendar appeared likely to be very heavy through July and August, and municipal offerings would probably continue in a steady stream.

Mr. Scanlon noted that he had heard reports of investors who were encountering difficulties in disposing of fairly large blocks of Government securities. He asked whether that was a general phenomenon.

Mr. Holmes replied that for tax reasons there was a tremendous amount of swapping going on now in the long-term market, as well as some outright selling. However, it was difficult to move large amounts of securities unless one happened to find a buyer with the right needs, because dealers were not willing to build up their positions.

Mr. Daane asked whether his understanding was correct that the Manager saw positive advantages in supplying some reserves through operations in coupon issues--in relieving the market overhang and countering downward pressure on bill rates--even though he might be moving against the trend of long-term rates.

Mr. Holmes replied affirmatively. As he had indicated, any coupon operations would have to be handled cautiously. But operations on a fairly sizable scale need not be disturbing to the market, given the availability of coupon issues at present and the demand for bills. And, in themselves, they need not have a major impact on interest rates.

Mr. Mitchell remarked that he was a little disturbed by the Manager's emphasis on the need for caution. It seemed to him that with the present state of market expectations the Desk would have to operate aggressively in coupon issues in order to have any significant effect.

Mr. Holmes replied that the volume of coupon operations that he had suggested might be feasible in the coming period--on the order of $250 million--was sizable relative to past System operations, although it was not large relative to the over-all volume of market transactions.

> By unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period May 2 through 22, 1967, were approved, ratified, and confirmed.

Chairman Martin 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. Koch made the following statement on economic conditions:

> It may be a late spring this year, meteorologically-speaking, but it was an early spring, economically-speaking. The news for March and early April was most encouraging, with consumption, production, and housing up; the unemployment rate steady at a low level; and the rate of inventory accumulation down sharply. But more recently, we have had a flurry of less favorable news again.
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> First, we learned that the earlier estimated rise in consumption had been exaggerated. Then, that employment and industrial production had been weaker in April. More recently, the news has included the fact that the real GNP actually declined a little in the first quarter.
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> To state my conclusion on the economic outlook before my evidence, let me say at the outset that I agree with the conclusion of the green book,1/ namely, that we had more or less anticipated the recent flurry of less favorable economic news and that our confidence in renewed, more normal economic expansion by the third quarter is not shaken. In buttressing this conclusion today, I should like to focus my remarks on two key areas of activity, namely, inventories and defense spending.

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

There is little doubt that the increase in inventories in 1965-66 was excessive and that an adjustment began in the first quarter. The March data confirm the fact that inventory accumulation declined from the very sharp annual rate of $16.5 billion in the fourth quarter of last year to about $5.5 billion in the first quarter of this year.

It also seems reasonably clear that more inventory adjustment remains. It is impossible, of course, to say what an appropriate level of inventories is at any given time. But if one assumes that the inventory-sales ratio of, say, mid-1965 was more or less normal, and if one assumes further that final sales this year will increase at about a 6 per cent annual rate, it would probably take a good part of the year for the inventories that are currently excessive to be absorbed. This conclusion also implies little further accumulation but no significant liquidation after March.

This is, of course, a grossly oversimplified way of trying to measure excessive inventories. For one thing, it implies the excess stocks are more or less uniformly distributed among the various industries. In fact, that is not true, for they appear to be heavily concentrated in durable goods lines, although no longer in autos.

A significant part is in the form of materials and supplies and work-in-process in defense industries. Another large portion is in the hands of manufacturers of construction and other materials and semifabricated products such as steel, nonferrous metals, and stampings. A third substantial amount is at wholesalers of consumer durables other than autos and various materials. This composition of the excess inventories may make the adjustment problem less difficult, at least as it applies to the eventual working down of the increase in materials and work-in-process associated with the defense production build-up.

In a sense, one's whole assessment of the economic outlook can be summarized in one word, Vietnam. We of course have nothing definitive to say about the likely future course of defense spending. But certain recent developments suggest that such spending will be significantly above the January Budget Document projections, both in the current fiscal year and next year.

The first-quarter estimate of defense spending in the GNP accounts has been revised upward twice--first, from an implied increase of $2.5 billion in the Budget to $3.3 billion in Commerce's first published figure, and now to $4.2 billion. Also, two independent sources suggest that spending in fiscal 1968 will exceed the figures given in the Budget Document.

First, Senator Stennis has suggested that a supplemental appropriation of from $4 to $6 billion will likely be needed next year. Secondly, a statistical calculation developed by our staff that relates GNP defense spending to current and lagged contract awards comes up with the conclusion that defense spending in fiscal 1968 could well exceed the estimates in the Budget by $5 billion or more. And to top it all off, the military and political news about Vietnam and now about the Middle East is certainly consistent with the judgment that defense spending is much more likely to be higher than earlier estimates.

The only news which on its face was contradictory to the assumption of considerably higher defense spending was contained in last week's testimony of Secretary Fowler and Budget Director Schultze before the House Ways and Means Committee. They suggested that the Administrative Budget deficit in fiscal 1968 might be $3 billion more than estimated in January, assuming enactment of the 6 per cent tax surcharge with an effective date of July 1. This estimate apparently implies an increase in defense spending of only about a billion dollars over the January projections. Both men admitted, though, that this deficit estimate and its implied defense spending figure could be underestimated. This may prove to be the understatement of the year.

In conclusion, some of the apparent contradiction between today's economic bears and bulls lies in the different time periods upon which they concentrate. The bears seem to be concentrating on the relatively near-term future and see at least a weak second quarter, the summer doldrums, and possibly a September auto strike ahead of us. The bulls, on the other hand, are looking beyond the summer and early fall and see a turnaround in the inventory situation coming at a time when total final private and Government sales in and of themselves may be absorbing more goods and services than the real resources of the economy can provide at stable prices--except for a relatively few months while the small volume of unutilized labor and plant capacity we now have are being put to work.

If this is a correct interpretation of many of the bearish and bullish views one hears today, both may be right. Assuming that the effects of monetary policy on spending spread out over a substantial time period, then the possibility of a relatively sluggish economy for the next few months and a strong one thereafter poses a difficult problem for monetary policy.

From my own point of view, however, I feel the economic outlook over both the near term and the longer run is still cloudy enough to call for continuation of our current policy of cautious ease. Moreover, and perhaps most importantly, we already have had a significant rise in long-term market rates of interest that may well have some dampening effects on housing and perhaps on other forms of investment in the period ahead.

Mr. Mitchell commented that Mr. Koch's remarks reinforced doubts he had had about the appropriateness of the second sentence in the staff's draft of the first paragraph of the directive.[1/] The sentence in question read "Output is still being retarded by adjustments of excessive inventories, but growth in aggregate final demands continues strong." To his mind that language implied strong growth in various categories of final demand. But strong growth did not appear to be evident in retail sales, or plant and equipment expenditures, or housing starts; it was evident mainly in defense spending. While a large rise in GNP was projected for the third quarter, at the moment that was still a projection for the future. On the basis of the evidence in the green book and Mr. Koch's statement, he doubted that the proposed sentence was justified.

1/ Alternative draft directives submitted by the staff for Committee consideration are appended to these minutes as Attachment A.

Mr. Hickman said that he had reached the same conclusion on first reviewing the staff's draft directive.

Mr. Koch remarked that the sentence in question seemed appropriate to him in light of first-quarter GNP developments, when total final sales rose about $15 billion. It was true that the rise in Government expenditures, at an annual rate of nearly 20 per cent, was unusually rapid, but personal consumption expenditures also increased at a rate of about 5 per cent. Within consumer expenditures, the evidence of weakness was limited mainly to durable goods; both nondurables and services were advancing at usual rates relative to income. It was not unreasonable to expect expenditures in the latter two categories to rise at their projected rates in coming quarters, and a turnaround in durable goods spending seemed likely.

More generally, Mr. Koch said, increases in real GNP at a 4 or 5 per cent annual rate--the most that could be expected--would imply increases of about $10 billion per quarter in the GNP at its current level. With Government expenditures advancing at their current rates, much acceleration in the rates at which other kinds of outlays were advancing would put substantial upward pressure on prices.

In response to Mr. Mitchell's question, Mr. Koch said he would agree that the main strength in the first quarter had been in

Government spending. Mr. Mitchell then observed that he thought it would be desirable to indicate that fact in the language of the directive.

Chairman Martin commented that Mr. Mitchell's point could be accommodated by revising the second clause of the sentence in question to read, "but growth in final demands, particularly Government, continues strong."

Mr. Daane said he was agreeable to pinpointing the Government sector in the manner the Chairman had suggested, without trying to specify the degree of strength in the rest of the economy. He personally was more sympathetic than Mr. Mitchell was to the view that there was evidence of strength elsewhere.

Mr. Partee made the following statement concerning financial developments:

> Expansion in the monetary aggregates has proceeded at very close to the projected rates since the last meeting of the Committee. Bank credit is increasing much less rapidly in May than in earlier months this year, as anticipated, and the outlook for June is for another moderate--though somewhat larger--rise. Business loan growth, in particular, has slowed markedly since mid-April. With continuing heavy capital market financing and some inventory liquidation projected, I would expect little strength in business loan demand over the summer, except for a temporary June tax date surge.
>
> Despite the recent slowing in bank credit expansion, average rates of growth over the first half still will be very high, reflecting our efforts to stimulate the economy and the associated resurgence in financial intermediation. But in a longer context this expansion can be viewed as a catching-up phase following the period of severely restricted

credit availability last summer and fall. Assuming that our June projections are about right, the rates of increase in the banking aggregates from mid-1966 to mid-1967 will have amounted to 6 per cent for the credit proxy, 11 per cent for total time deposits, and 2-1/2 per cent for the money supply. All of these increases are a good deal below the average rates of growth experienced in the two preceding years of high prosperity.

Similarly, the first-quarter flow of funds estimates show a sharp increase in total credit expansion, featured by a massive shift towards financial intermediation. But the $70 billion annual rate for total credit raised is not much different from the figures for 1965 and 1964 and is well below the increases of late 1965 and the first half of 1966. Moreover, the ratio of private borrowing to net private investment outlays in the first quarter remained somewhat lower than it had been prior to mid-1966. Thus I can see no reason, either in the banking numbers or in total credit flows, for faulting the performance of policy over this period, nor for changing its stance at present. Renewed vigorous economic expansion later on may require increased restraint in time, of course, but I agree with Mr. Koch that the current situation remains rather spotty and that that decision need not be made now.

Of immediate significance to the Committee, however, are the continuing disparate movements in interest rates. The Treasury bill market has continued very strong, with the 3-month rate down 25 basis points further since the last meeting of the Committee. But the capital markets have remained under exceptional pressure; yields on long Governments, municipals, and new issue corporates have increased by fully 40 basis points over the last 6 weeks and are again within hailing distance of the record highs reached late last summer.

Both developments reflect in important degree the continuing deterioration in investor expectations for the future course of interest rates and bond prices. Most if not all market participants seem convinced that there will be a sharp economic upswing later in the year, are concerned about the possibility of a major intensification of the war in Vietnam, foresee the need for very large Federal deficit financing operations in the second half, and anticipate continuing strong private credit demands, at least in long-term markets. Under these circumstances, there is a strong and pervasive desire for liquidity by investors, and a correspondingly weak interest in long-term fixed-dollar commitments.

There obviously is substance to these apprehensions, but the question is one of degree--has investor sentiment, and therefore the change in yield levels, been overdone for now?

In short-term markets, constraints on the supply of instruments do appear to have played an important role in the yield decline. The supply of Treasury bills available to the public has dropped unusually sharply this year, reflecting retirements and official purchases by the System and by the Home Loan Banks, and banks have not seemed especially eager to push up their totals of short CD's. After mid-year this situation is likely to reverse, as the supply of short-term Government securities increases sharply with deficit financing and banks perhaps become more interested in issuing Cd's to finance fall loan expansion. In long-term markets, supply has also played an important role--in the opposite direction--as buyers have had to absorb record volumes of corporate and municipal bonds, as well as large amounts of participation certificates. But here, unfortunately, the prospect of a reversal after mid-year is far less certain.

The major congestion in long-term markets has been in the corporate area, where public bond offerings have been truly massive. In the first four months, such offerings amounted to $4.6 billion--nearly double the year-earlier total--and no respite is in store for May and June, when calendars continue very heavy. There are three possible grounds for expecting a decline in new issue volume later on. First is that corporations, having reduced liquid asset holdings much less than seasonally early this year, may soon reach desired liquidity ratios once the very heavy second-quarter tax payments are out of the way. The second is that private placement activity is on the rise, which may serve to shift financing from the more interest-sensitive public market. And the third consideration is that the spread by which corporate outlays for fixed investment and inventories has exceeded internal funds is declining sharply as the year progresses.

Nevertheless, it would be extremely hazardous to predict a decline in future capital market financing, in view of the great influence that the decisions of a relatively few corporations can have on the totals. In the first four months of this year, for example, the surge in financing was mainly attributable to the fact that 30 corporations chose to make public bond offerings of $50 million or more, as against only 13 in the same period last year. Most of this increase represented the issues of manufacturing corporations that seldom come to market. There is a large number of such potential borrowers, and more could decide to come to market because, for example, they wish to reduce their dependence on bank financing or squirrel up liquidity as a hedge against the future. And most such manufacturing firms would probably not be dissuaded by historically high interest rates, particularly if they think rates may move higher in the year or two ahead.

High interest rates can influence other borrowers, however, including smaller business enterprises, State and local governments, and home buyers. And many investors can be influenced in how they commit their funds by the differentials in yields available. It seems clear, for example, that the recent sharp rise in bond rates presents a threat to full recovery in the mortgage market. Institutions with flexible investment latitude already appear to be diverting important amounts of funds to the bond market, and are likely to become progressively less interested in pushing for mortgage commitments if the yield spread as against bonds narrows further from what already is an all-time low. Major support for the residential mortgage market is coming from the savings and loan associations, of course, but the record inflows to these and other intermediaries could be jeopardized too if savings rates are reduced at midyear or if the rise in market yields spreads into the intermediate-maturity instruments that provide a better substitute for deposits.

It seems altogether too early in the recovery to curb the flow of mortgage and other non-business credit. Moreover, a continuing uptrend in long rates could prove exceedingly dangerous, coming on the eve of heavy Treasury demands in the short and intermediate markets. There could be an escalation in the whole rate structure that would be at least premature, if not unwarranted, in terms of the economic outlook.

If we are in the midst of a strong upward trend in long-term rates, there may be little that the System could or should do to stem the tide. But some of the current borrowing may be anticipatory, and investor sentiment may be too sour for prospective near-term economic developments. If so, the stage may be about set for a market rally, which the System could encourage and help set in motion by focusing

> its operations on coupon issues during the next few weeks, when a net of more than one-half billion dollars in additional bank reserves needs to be provided. The Committee's desire to aid long-term markets, to the extent feasible within the context of the System's normal reserve supplying operations, could be recognized explicitly by adoption of alternative B for the directive, which I would recommend.

In reply to a question by Mr. Ellis, Mr. Holmes said that the Treasury probably would have to raise cash in the market shortly after mid-year.

Mr. Hickman referred to the proposal that part of the reserve needs in the coming peroid might be met by buying coupon issues rather than bills. He asked whether any thought had been given to the possibility of also selling bills, which were in short supply, and concurrently buying intermediate- and long-term bonds.

Mr. Holmes said that for the peroid immediately ahead the Desk had enough room to operate in coupon issues without engaging in the type of operation Mr. Hickman had mentioned. There were risks in over-doing coupon operations, although at present the technical position of the market was favorable to them. The Desk's action yesterday in bidding so as to let $100 million of its bill holdings run off might be viewed as a small step in the direction suggested.

Mr. Hickman then remarked that concurrent sales of bills and purchases of coupon issues might be kept in mind as a possibility for the future, if the present market situation persisted.

Mr. Partee observed that such swaps would be an important departure from past practice. In any case, they were not likely to be necessary in the coming period, when the Desk would have the latitude to buy as much as $500 million of coupon issues in the course of meeting reserve needs. After that, of course, the Committee might need to consider the bigger step of engaging in swaps, depending on market conditions at the time.

Mr. Mitchell asked what was happening to the proceeds of the current heavy corporate bond offerings. In particular, were they being invested in short-term market instruments? Did corporate buying account for much of the recent demand for bills?

Mr. Partee said that the available data indicated that the first-quarter decline in corporate liquidity was much less than seasonal. In that period corporations may have bought CD's and bills, although the supply of bills available to the public had declined sharply this year, and CD's outstanding had not been rising recently. Commercial paper, however, had been expanding rapidly. Bank loan figures suggested heavy business loan repayments in the last few weeks, probably reflecting in part the use of bond financing proceeds.

Mr. Hickman asked whether there were any indications that the recent tendency for borrowers to bypass the banking system was putting pressure on the prime rate. In his judgment the current prime rate was too high by at least 1/2 point.

Mr. Partee said he had heard relatively little discussion of the prime rate recently.

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

> I want to speak this morning about the long-run problem of the balance of payments. But four points about recent developments are worth recalling first. One is that during the seven months just past, the liquidity deficit before special transactions has been running at a rate near $1 billion a quarter, having been swollen by heavy imports, by increased military expenditures abroad, and perhaps also by unidentified movements of U.S. business funds into sterling. The second point is that within this recent period, the merchandise trade balance has improved: imports have passed their peak and exports seem to be still rising. Third, identified flows of private investment funds largely offset the trade improvement in the first quarter of 1967 and kept the adjusted liquidity balance from improving much. Finally, the deficit on the basis of official reserve transactions has been very large this year because of the repayments to the Euro-dollar market by U.S. banks; but very recently the outflow of these repayments has stopped and given place for the moment to some inflow, paralleling the renewed efforts of some banks to get domestic CD money.
>
> The international economy, like our own, has been standing almost still the last few months. This is going to be a testing time for U.S. exports. It may also be a good time to take a look at the long-run problem of the balance of payments.
>
> There are really only three kinds of paths to international exchange equilibrium for the United States to take. Some day the country might simply give up, in a desperate gambler's mood, and resign

to other countries the fixing of exchange values for the dollar. The consequences would be unpredictable, but probably chaotic; as Mr. Solomon suggested three weeks ago, we might end up with an undepreciated trade dollar and a depreciated capital dollar. Or, the country might take the path of isolationism, raising tariffs to keep imports out and building up administrative restrictions to keep capital in. Or, thirdly, we can still aim to make headway along the path we think the country prefers and should prefer--that is, the path symbolized by IMF, GATT, and OECD, a path of rational international cooperation.

When I use words like those, the first questions you must be asking are what kind of cooperation do we want and how are we to get it. Within the government, questions like these receive attention, but it is a pity that in the public mind the question of cooperation to get balance restored has not taken root; it has been squeezed out by the questions of cooperation to finance the U.S. deficit and avoid speculative disturbances, as well as by the separate question of cooperation to invent a supplementary reserve asset.

Any cooperative solution for restoring equilibrium will have to include elements relating to trade, to investment and aid for the nonindustrialized world, to capital movements among the industrial countries, and to military expenditures. The Europeans do not see eye to eye with us on the various elements of a solution, but it is much too soon to give up hope.

We cannot expect the Europeans to inflate their price levels deliberately so as to bring about a realignment of prices and costs within the present exchange rate structure--a realignment that I for one think is very much needed to help restore equilibrium. French and Italian policies in 1964 and British and German policies in 1965 and 1966 are proof enough that they will all resist inflation at one stage or another. Nevertheless, it is open to us to outdo them in maintaining price stability--and if we can do that, they can hardly disapprove. They may not always like U.S. competition, but there is universal acceptance that price stability in the United States is an essential element for a cooperative solution.

With respect to capital and aid, the United States, as you know, puts much emphasis on the need for development of European institutional structures and fiscal policies for a more effective mobilization of savings and for its channeling into foreign lending and aid. The Europeans, for their part, have urged us over the years to let U.S. interest rates rise and to put administrative restraints on U.S. capital outflows. By last year we had gone quite a distance along these lines, and many Europeans are not so sure now of what they want us to do.

I must turn to what this Committee is directly concerned with: the relation of U.S. monetary policy to any cooperative cure of the imbalance in international payments. Two principles define the relation adequately, I think. First, because the balance of payments cure is a slow matter, <u>changes</u> in U.S. monetary policy should usually be determined only by domestic needs and objectives. But, secondly, because an essential ingredient of any cooperative solution for the balance of payments is U.S. price stability, the general slant of U.S. monetary policy should be <u>biased</u> toward the price stability objective--more so than if we had no external deficit to get rid of.

During the past six or seven months the Committee has deliberately disregarded the second of these principles. Last autumn the three largest economies of the western world, those of the United States, Germany, and Britain, were either on the edge of recession or in it. From every point of view, the top priority then was to prevent a world recession. The Federal Reserve acted rightly in its role of international leadership, by temporarily giving low weight to the balance of payments and future price stability.

We should now be asking ourselves some hard questions about ways and means of preventing price inflation. Such as: by what means should the United States maintain growth and stability without allowing industrial capacity utilization to rise so much as to provoke an inflationary boom? And, for example: is it necessary or desirable that total non-Federal debt in the U.S. economy go on rising from year to year at an average rate as high as 8 per cent, as it did in the decade through 1965? Or, more generally: are low long-term interest rates really necessary for growth?

Long before questions such as these are resolved, we shall have to face a question of timing. Even today we must ask whether the danger of world recession is now past, and whether Federal Reserve policy should now again give special weight to price stability for balance of payments reasons. I cannot give an unequivocal answer of "yes" today. In Germany, the key country in Europe in this regard, we do not yet have evidence that an upturn has started. Information just received on British industrial production suggests that the cyclical recovery there around the year-end was tending to peter out in February and March. You have heard what Mr. Koch and Mr. Partee have said about the U.S. economy.

Whatever the timing may be, it seems clear that once a new advance does get strongly under way the problem of maintaining price stability will force itself on us.

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

Recent statistics show the economy in a sideways movement. Reduced inventory spending appears to be offsetting a substantial increase in final demand. The business atmosphere has become less buoyant and perhaps more realistic than it was only a few weeks ago. The economic situation, however, has strengthened in several fundamental respects. The inventory adjustment is apparently proceeding in a rapid but orderly fashion, while the housing indicators have continued to strengthen slowly. These developments are consistent with an outlook for renewed and strong economic growth in the latter part of the year. The continued sluggishness of consumer buying remains a major source of uncertainty in the private sector of the economy, but the recent rapid build-up of consumer liquid savings, as well as the continued growth in personal income, suggests that some strengthening in this sector is the most likely prospect.

At the same time, the Federal budget is highly stimulative. It is apparent that there will be no increase in income taxes at midyear. The fiscal stimulus in the second half of 1967 is likely to be of record or near-record proportions. The prospect for a simultaneous push later in the year, from both a highly stimulative fiscal policy and renewed strong total private demand, is reminiscent of the situation that occurred in late 1965 and early 1966 when economic over-heating became all too apparent.

The dangers of a reemergence of excessive demand pressure are heightened by the cost pressures that are now being created by generous wage settlements. I get the impression that 6 per cent annual wage increases, combined more often than not with cost-of-living escalator clauses, are now viewed as attainable targets in wage negotiations. With food prices likely to move higher in coming months, new wage demands may be even greater, while the escalator clauses under existing contracts will provide a further push in wage costs. All of this suggests that if excessive demand pressures develop on the scale of late 1965 and early 1966, there are likely to be even more serious price consequences than at that time.

The prospect for a renewal of rapid price increases and tight supply conditions in domestic markets becomes especially disturbing against the backdrop of recent balance of payments developments. The situation here is clearly deteriorating despite substantial recent improvement in the trade surplus. The reported liquidity deficit in the first quarter of the year was at a seasonally adjusted annual rate of $2.2 billion, but after the elimination of special transactions the underlying deficit was over $4 billion. Both of these deficit measures were about unchanged from their high fourth-quarter rates despite a $1 billion rise in our trade surplus rate. Moreover, the deficit on an official settlements basis was at a $7.3 billion seasonally adjusted annual rate in the first quarter, up from $100 million in the fourth quarter of 1966. The large official settlements deficit reflects a shift of foreign private dollar holdings into central banks. Some of these shifts resulted from easier conditions in the United States money markets, and were reflected in the decline of U.S. bank borrowings in the Euro-dollar market. The disturbing over-all balance of payments situation in the first quarter of the year appears, moreover, to have continued in April, judging by the results of the flash report on the liquidity deficit for that month.

Turning to the banking and general financial situation, it seems clear that liquidity rebuilding and the corporate tax speedups have been the dominant factors in the large increases this year in bank credit and total credit flows. In May, however, bank credit is apparently rising little if at all, and the June forecast is for growth on a comparatively modest scale despite another surge in corporate tax payments. Such slowdowns are not disturbing in view of the sharp increases earlier this year, although a somewhat higher May-June average than is currently forecast would not be inappropriate.

There is a large flow of funds into the savings banks and savings and loan associations. Mortgage credit is readily available. But current corporate issues are attractive to savings banks, and a number of savings banks are acquiring modest amounts of such issues. Interest rates on conventional and insured mortgages have been declining since last winter, but very recently we have seen at least one sign of a reversal in the direction of rates on conventional mortgages and scattered reports of increases in rates in the secondary market for FHA mortgages.

The most striking current financial developments are in the long-term securities markets. Here rates have been under increased pressure since immediately after the recent discount rate reduction. Corporate and municipal borrowings have been at record high levels, and the markets are facing the prospect of very heavy borrowing through the remainder of the year by the U.S. Treasury and some of the Federal agencies. Although some long-term borrowing rates are approaching the peak levels of 1966, this seemingly is having little effect on willingness to borrow.

The heavy corporate credit demands partly reflect the need to rebuild depleted liquidity positions and the heavy tax payments resulting from corporate tax speedups. Two other factors are probably also at work. First, the credit squeeze of last year may have led to a desire to increase liquidity as a hedge against a possible recurrence of the 1966 experience. Such a change in liquidity preference does not imply any definite planning by corporations to use such funds to finance spending on goods and services; rather it would be a precautionary measure. Second, a part of the heavy demands may reflect a decision to accumulate funds now that will be needed for spending later this year or early next year. These two factors obviously have differing implications for the prospective strength of private demands for goods and services in the months ahead. But, with respect to interest rates, it seems to me on balance that as the second half of the year progresses, forces will be working toward higher, rather than lower, rates. Presumably the greatest effect will be on short- and intermediate-term rates, but there could also be some further rise in long-term rates.

In summary, while the aggregative statistics remain on a plateau, the domestic economic outlook has strengthened. It will probably be at least a few more months before a clear uptrend in the economic indicators is firmly established. At the same time, market forces have resulted in a substantial and sustained rise in long-term interest rates despite continued ease in the short-term areas of the market. The rise in long-term rates carries with it the possibility of slowing the prospective economic upturn, especially in the housing sector.

Against this background and the poor international balance of payments situation, it seems to me that monetary policy should remain essentially unchanged over the coming four weeks, and that open market operations should be conducted with a view to maintaining about the prevailing conditions in the money market.

During the coming weeks the routine or market factors presumably will be absorbing reserves, and thus the System will need to supply reserves in order to maintain prevailing money market conditions. In such circumstances the purchase of coupon issues would seem desirable. Such purchases in moderate amounts in the light of availability should tend to relieve some of the pressures on the long-term markets generally. Aggressive buying could generate undesirable and even perverse shifts in market expectations, especially if the markets were to conclude that the System had a specific interest rate objective in mind. Caution toward buying in the longer-term markets for the purpose of relieving pressures in those markets is also reinforced by the strong economic outlook for the months ahead.

As for the directive, I prefer alternative A. I assume, with respect to the two-way proviso clause which

> is included in alternative A, that it is the current expectation that total bank credit will rise at a rate of about 5 per cent. I would expect the Manager to act under the proviso clause if the growth rate of the credit proxy were to fall much below that level or to rise substantially to, say, a 10 per cent level.

Mr. Ellis commented that perhaps the best way to highlight what was occurring in New England was to contrast what the statistics were saying about employment, production, and construction with the attitude of buoyancy and optimistic outlook that prevailed. For example, initial claims for unemployment compensation had been more numerous than a year ago for thirteen consecutive weeks through May 6. And yet the papers were crowded with advertisements of job offerings, labor turnover was extremely high, and there was no evident concern about difficulty in securing jobs. Workweeks of manufacturing production workers had continued to contract slightly and overtime had been reduced at some nondefense plants, and yet workers were confidently seeking, expecting, and in many cases winning wage increases even though their contracts did not provide formally for wage negotiations this year.

In contrast to the U.S. pattern, Mr. Ellis continued, residential construction contracts had been declining in the last several months, but the increased availability of mortgages had accelerated the amount of planning for new construction and the market reflected that optimistic sense of moving ahead.

Mr. Ellis regarded the consumer spending pattern as a confusing mixture of gains and losses. The Boston Reserve Bank's seasonally adjusted April index for department store sales was down from its March level but held a few points above its year-ago level. Department store sales in the reporting sample for the four weeks ending May 13 were 8 per cent better than those for the same period of 1966, but that relatively good performance only neutralized the poor performance earlier in the year. Cumulative sales for 1967 were just matching those of last year.

He would point out, Mr. Ellis said, that the volume of business transactions must be increasing. The number of checks the Boston Bank handled during the month of April exceeded year-ago volume by 12 per cent. On a dollar-value basis, checks cleared in the four weeks ending May 3 ran 16 per cent ahead of last year's comparable period. Credit flows in the District were dominated by signs of more widespread easing. At District savings banks the rate reductions on mortgages he had reported for the Boston banks at the previous meeting had now become widespread. Of the 70 non-Boston savings banks in the District 28 now reported their most common rate at 6 per cent. One bank had reported a 5-3/4 per cent mortgage rate. On the other hand, the rates paid on deposits continued to rise; seven of the 80 banks in the reporting survey increased their rates in April. Sixty-five per cent of those banks now reported 4-1/2 per cent as the rate they paid. Discussions with District savings bankers revealed some desire on their part for a lower rate on their deposits, but no willingness to start a downward trend. Happiness with the inflow of funds did not incline them to upset the relationships which supported that inflow.

At commercial banks, too, liquidity was rebuilding compared to a year ago, Mr. Ellis continued. Investment portfolios had been increased by about 25 per cent, with the major source of funds being the time deposit sector. Time deposits had grown 21 per cent in the past year in the First District, compared with 8 per cent for the nation. With loan demand unchanged or only slightly stronger, banks' willingness to supply funds was definitely greater than it had been three months ago. There was evidence also that the banks were reaching into the fall maturities in signing up CD's. Long-maturity CD's had been getting the largest boost in rates, which had ranged upward to 25 basis points in the First District. Banks appeared to be providing themselves with funds for use late in the year when business bank loan demand could rise appreciably. District insurance companies reported that policy loans seemed to have leveled off at a rate approximately twice their 1965 level, and that an increase in mortgage payments and in other flows of funds had permitted them to resume commitments at a rate comparing very well with the 1965 level.

Mr. Ellis found the staff analysis presented in the green book and the blue book in advance of today's meeting to be especially useful because it concentrated more than usually on projecting the probable course of the economy for the remainder of the year. He agreed very much with the tone of that analysis and with Mr. Koch's comments this morning, and was glad to see the emphasis on final demand in the analysis. He found himself wanting to take issue with the projections at only two points, at both of which he thought the analysis was more conservative than was warranted. His first question related to the projection for "only a moderate growth in consumer expenditures in the second and third quarters."1/ He had difficulty accepting

1/ The language quoted by Mr. Ellis was employed on page II-4 of the green book, in the context of the following passage: "In real terms, the rise in disposable income in the first quarter was larger than in any quarter of the past year. Although the second quarter flow of income will be somewhat smaller, the increase in spending power will still be substantial. Gains in total employment--although not in industrial employment--and wage rates are continuing, while the small increase in the personal tax-take in the first half of this year is leaving an unusually high proportion of income gains in consumer's hands. These high levels of real income have been reflected in an exceptionally high and rising saving rate over the last six months, and consumers are therefore in a position to step up spending. However, total retail sales are still sluggish, and since extended periods of high rates of consumer savings have occurred before, we are projecting only a moderate growth in consumer expenditures in the second and third quarters."

the logic of the argument that the occurrence of extended periods of high savings rates in the past was adequate reason to expect only moderate growth in consumer spending. The facts that incomes were growing rapidly and that savings had been high would incline him to expect a step-up in consumer spending of significant proportion--and he said that knowing the retail sales data for March had been revised downward.

The second point at which Mr. Ellis' expectation differed from the staff's related to the estimates of Federal expenditures underlying the projections of the high-employment deficit shown in the table on page III-18 of the green book. As he read the numbers, the staff's estimates were conservative. In particular, the projected third-quarter high-employment Federal deficit of $10.2 billion seemed to him to be an underestimate, and portended an even higher fourth-quarter deficit.

Unhappily, Mr. Ellis said, both of those differences in projections served only to intensify concern for the inflationary pressures that would be present in the economy in the third, and especially the fourth, quarters of this year. In that connection Mr. Hersey had done the Committee a service in reminding it of the importance of preserving price stability for the sake of the balance of payments.

In seeking to translate such economic projections into policy prescriptions, Mr. Ellis continued, one obviously arrived first at a conclusion that fiscal policy as presently projected was quite inappropriate for the needs of the economy. Not only would fiscal policy be very stimulative; debt management would be impeding the possibility of utilizing monetary policy smoothly and effectively. The unprecedented borrowing needs, on the order of $18 billion, between July and December of this year obviously translated into frequent and large Treasury issues in the capital market. The obvious desirability of avoiding major shifts in monetary policy during the course of Treasury financing would mean that the opportunities for shifting policy after early July were very likely to be limited.

In Mr. Ellis' opinion those reflections added up to a very uncomfortable choice facing the Federal Reserve. The projections clearly indicated intentions of consumers, business, and Government to be spending at levels which could not be satisfied by an economy already operating with high rates of utilization of its labor resources. The mechanics of Treasury financing were going to make policy moves difficult to schedule between July and December, and yet between now and the first of July it was quite likely that the unemployment rate might move up fractionally and there might be additional public attention given to slight declines in the capacity utilization rate in manufacturing. But because monetary policy worked with a lag, because the projections were firm, and because later changes in policy would be difficult, in his judgment the trend of policy should be gradually shifted into a posture of lessened ease between now and the first of July. It should become clear to the market that the Committee was not pressing to maintain a rapid rate of bank credit expansion as a continued means of resisting recession. Mr. Koch had used the phrase "cautious ease" to describe the Committee's current policy. He (Mr. Ellis) would urge rather a little more caution and a little less ease.

From that point of view, Mr. Ellis said, it would be clearly inappropriate to put major emphasis on coupon operations designed to tip long-term rates into a downward path. The volume of coupon purchases the Manager had suggested--$250 million--was quite large, and would signal a continued intention to fight recession with further ease. He thought the Committee could not stem the tide of rising long-term rates, and an effort to do so would be interpreted as a deliberate policy move.

Furthermore, Mr. Ellis remarked, the existence of high long-term rates must be having some marginal effect in restraining capital investment. In view of the GNP projection, the Committee might logically conclude that it should be thankful for whatever restraint such rates will have provided by next fall. Without prejudice to the value of coupon operations on some occasions, he saw no long-range objective in their intensification at this time and he would reject alternative B of the directive drafts.

In keeping with the objective he had expressed of beginning to tip policy toward less ease, Mr. Ellis said, he would urge that the proviso clause of alternative A be amended to provide for offsetting only those deviations of bank credit expansion in excess of the projected 4 - 7 per cent growth rate. That could be done quite simply by inserting the word "upward" before the word "deviations" in the proviso clause of alternative A.

Mr. Irons reported that economic conditions in the Eleventh District were strong. Although rates of increase had moderated considerably and the District economy was moving sidewise, activity was at a very high level. The employment situation continued to be very tight around such major cities as Dallas and Houston, where unemployment rates were running in a 1.9 to 2.2 per cent range and the numbers of employed persons rose each month. The District production index had remained about unchanged for the past two or three months, with activity in both durable and nondurable goods industries relatively stable. Residential construction was down from its year-ago level, but nonresidential construction was up and total construction activity probably was up slightly. Department store sales were 7 per cent above a year ago in the week ending May 13, and for the year to date they were up about 4 per cent. Automobile registrations were running about 8 per cent below last year. The picture in agriculture was mixed; moisture conditions had become good recently in large areas of the District, but in the western part there continued to be a serious need for moisture.

In the financial area, Mr. Irons said, bank loans, demand deposits, and time and savings deposits were all down less than seasonally during the past three or four weeks. Most of the loan decline was in loans on Government securities; commercial and industrial loans were up by a moderate amount. The decline in time and saving deposits was due largely to a reduction in large CD's, although some bankers also reported that there had been some slowing of growth in consumer-type CD's. District banks, especially the larger banks, were more liquid now than at this time a year ago, just prior to the intensification of monetary restraint. However, they were not as liquid as they would like to be, in view of the loan demands they anticipate. They also pointed out that, if it became necessary for the System to shift toward restraint again this year, the impact upon bank liquidity might be more rapid; thus, their concern with the current liquidity position, even though it is somewhat better than a year ago.

Member bank borrowings from the Dallas Reserve Bank had been negligible recently, Mr. Irons continued, but District banks had increased their borrowings through the Federal funds market and in total were sizable net purchasers of Federal funds. Some District banks were maintaining day-to-day balances of funds purchased ranging from $25 - $35 million up to as high as $85 - $95 million.

With respect to the national economy, it seemed to Mr. Irons that the situation was one of continuing adjustment of a sort that the Committee had desired and had hoped would occur smoothly. The current inventory adjustment, and the related adjustments in industrial production and employment, seemed to him to be of that type. There apparently also had been an adjustment, if that is the word for it, between consumer income and expenditures, with the savings rate rising somewhat. Defense expenditures were continuing to rise, with no promise of moderating. He was concerned about the wage pressures that might develop and was inclined to agree with Mr. Treiber regarding the possibility of settlements involving 6 per cent increases. Such wage rises would have a substantial effect on prices.

In Mr. Irons' judgment the money markets had performed reasonably well in the past few weeks, but the capital market certainly had been under pressure. Increasing numbers of observers appeared to be expecting tighter money market conditions. There was general concern about the Federal budget deficit and the means by which it would be financed; if an expansionary credit policy was to be employed to help finance it, it was expected that the System would be fighting inflation again soon. He found very few people who anticipated much help from fiscal policy. On the contrary, stimulative rather than a restrictive fiscal policy was anticipated. There also was concern about the U.S. balance of payments position. While the trade sector had shown improvement recently, other sectors had deteriorated to the point at which the over-all balance of payments problem continued to be serious. Also, more people were becoming concerned about recent events and speculations with respect to silver and gold. The typical Eleventh District businessman did not like the notion of tinkering with U.S. gold policy.

Against the background of that general situation, Mr. Irons felt that this was a good time for the Committee to indicate by its actions that no change was being made in credit policy. He liked Mr. Koch's phrase, "cautious ease," and thought that should be the Committee's objective. He favored alternative B for the directive because it pointed up the problem that the Committee had been and would be facing in the capital market. He agreed that caution would be necessary in operating in coupon issues; it would be unfortunate if the market came to believe that the Committee was virtually pegging long-term rates or setting a pattern for them. But it might be well to engage in operations in longer-term securities within reasonable limits and at times when the Desk judged such operations to be feasible, simply to give some support to the market and without leaving the impression that the Committee was attempting to peg a rate or a pattern of rates. With that qualification, he favored alternative B.

Mr. Swan remarked that developments in the Twelfth District had contributed to the weakness in the national statistics for April. The unemployment rate in the Pacific Coast States rose sharply to over 5 per cent, with reductions in employment most marked in agriculture, construction, and manufacturing. However, unusual rains and cold weather during much of April undoubtedly played a significant role in that situation. The weather probably was a major factor in the weakness in construction activity and lumber production; it probably explained in good part the drop in housing starts in the West at a time when such starts were rising elsewhere. District fruit and vegetable crops also had been adversely affected by weather during the period. Seattle was the one booming area in the District; indeed, it was the only metropolitan area in the District, out of 60 in the country, that had a "B"--or "low unemployment"--rating.

In the three weeks through May 10, Mr. Swan said, total credit at the District weekly reporting banks declined about $350 million, about equally divided between loans and investments, in contrast to an increase of about the same amount in the corresponding period of 1966. The major banks remained net buyers of Federal funds and were maintaining a considerable volume of loans to securities dealers. As elsewhere, interest rates on longer-term CD's had moved up fractionally in the last few weeks, although currently there did not seem to be any great pressure on banks to obtain funds. Scattered replies from the mid-May survey of bank lending practices suggested a difference between the current situation and bank expectations for the longer run. The replies indicated both increased willingness by banks to make most types of loans currently and expectations of moderately stronger loan demands over the next few months.

Last week, Mr. Swan continued, one California mortgage company based in Los Angeles announced an increase in rates on residential mortgages. That company advised that the action reflected a decision by its principal outlet, the Metropolitan Life Insurance Company, to favor other investments over residential mortgages. There had not been similar increases by other lenders in California nor, as far as he was aware, by correspondents of Metropolitan Life elsewhere. Certainly, mortgage funds were still available through savings and loan associations at rates below that announced by this mortgage company. Nevertheless, the action was an indication of some pressure in the mortgage market.

Mr. Swan said he had nothing to add with regard to the national economic situation; he was essentially in agreement with the analysis given in the green book and by the staff this morning. As to policy, he also thought that the Committee should maintain prevailing money market conditions and should continue about the present stance of over-all reserve availability, given the bank credit projection for June. He would hope, however, that bank credit growth would be closer to the lower end of the 4 - 7 per cent range projected than to the higher end. The money market conditions specified in the blue book seemed rather reasonable to him, but if the recent heavy demands for bills and other short-term instruments persisted he would expect the Federal funds rate to be somewhat below 4 per cent, even though other money market conditions were maintained as at present.

Given prevailing conditions in the capital market, it seemed to Mr. Swan that some purchases of coupon issues would be justified in the coming period within the reserve-supplying operations that would be undertaken in any event. He would not want purchases of coupon issues to go so far as to create an impression that the Committee had rate objectives. But it did seem appropriate to attempt to relieve some of the pressures and to maintain orderly conditions in that area.

Mr. Swan said he had a few comments on the draft directive. The opening sentence of the first paragraph said that ". . . renewed economic expansion is in prospect" without any indication of timing. He would prefer to have the statement read, ". . . renewed economic expansion later in the year is in prospect." With respect to the alternatives for the second paragraph, it was true that the Committee had engaged in operations in coupon issues in the past without mentioning them specifically in the directive. He believed, however, that under present circumstances a reference in the directive was desirable. Accordingly, he preferred alternative B to A. But he had two questions about the language of B. First, the phrase, "insofar as practicable" in the final clause of the draft seemed to him to raise many questions. He would suggest dropping that phrase, and adding the word "unusual" before the word "pressures." The clause would then read, "while moderating unusual pressures in the capital market." Secondly, whether the Committee adopted alternative A or B he felt strongly that it should reintroduce the proviso clause, which had been deleted from the directive adopted at the preceding meeting only because even keel considerations were dominant then. He could accept either a two-way clause such as was shown in alternative A or the one-way version that Mr. Ellis had suggested. If a proviso clause was added to B, however, he thought its opening words should be, "but open market operations shall be modified," rather than "but operations shall be modified," to make clear that the reference intended was not to operations in coupon issues.

Mr. Galusha commented that the Ninth District economy still seemed to be going along nicely. It was not growing as rapidly as it had been, but through the first quarter it grew more, relatively, than did the national economy. He had never thought of his District as being an arsenal of democracy but obviously defense orders had had a lot to do with maintaining the growth of output.

Optimism remained high among nonagricultural producers in the District, Mr. Galusha said. So far, there had been no hint of impending cutbacks in capital spending. One could find differences of opinion about the near-term future of construction, but his judgment was that optimism dominated. He had even heard talk of an increase in mortgage rates. There was a very sharp increase in building permits in April. Expectations in the construction industry were high. Lumber production in Western Montana had increased, but proof of sustainable recovery had yet to come in.

The mood of agriculture remained dark, Mr. Galusha continued. Farmers and cattlemen continued unhappy. Although generally there would be increased acreages, distrust of long-run U.S. Department of Agriculture objectives would keep plantings below maximum acreages. There was no credit pressure anticipated from agriculture in the District this year.

Mr. Galusha commented that he had little to say this morning about monetary policy. It might be doubtful that further purchases of coupon issues, even if sizable, would produce a sharp decline in long-term rates. Such a decline would come only when financial markets became convinced that taxes were going to be increased. In visits yesterday on Capitol Hill he had found a surprising receptivity to a tax increase and a good deal of unhappiness that the Administration was not openly pushing for its tax program. That attitude was based on many things, but mainly on mail indicating that people wanted to have a sense of sacrifice and of participation in the war effort.

It was not clear, Mr. Galusha continued, that long-term rates should be a good deal lower than they presently were, given the staff's appraisal of economic prospects. Granting that, he still would be more comfortable if long-term markets were less plagued by uncertainties than they appeared to be, or were feeding less on what hopefully were false expectations. At the moment, there might be no good case for appreciably lower long-term rates. But there also seemed to be little point in letting those rates go to levels which, come fall, would appear too high.

Translating that view into directive language presented the same problems to him as it had to Mr. Swan, Mr. Galusha said. But if he understood Mr. Swan's proposed language correctly, it would seem to give ample latitude to the Desk to curb its operations in the coupon area if it appeared that they were leading to the substitution of a new set of false expectations for the present ones.

Mr. Scanlon remarked that the economic picture in the Seventh District was similar to that reported at the last meeting. A rapid, even inflationary, upswing was widely expected for the remainder of the year, but available statistical evidence on employment, output, orders, and retail trade did not yet support that view.

The most spectacular development of the past few months, Mr. Scanlon said, was the large increase in new claims for unemployment compensation, which were no longer confined to the auto industry. Reports of Chicago purchasing agents for March and April showed faster deliveries and shorter order lead-times; stable inventories, production, and employment; lower new orders and backlogs; and poorer profits. Farm machinery had now experienced a letdown in demand, probably associated with the recent decline of farm income. Tractor sales in the Corn Belt were off more than 15 per cent from last year in the first quarter and by more than 25 per cent in March.

Banking data currently did not offer useful evidence as to the underlying strength of loan demand, Mr. Scanlon continued. The decline in outstanding loans during the first half of May was contrary to the usual pattern, but was not unexpected following the heavy tax borrowing in March and April. District bank experience was similar to that for the nation except for a relatively stronger increase in real estate loans. The first District responses to the quarterly survey of bank lending practices indicated "no change to moderate easing" in loan posture compared with three months earlier.

Mr. Scanlon went on to say that because of the huge volume of financing in the capital markets and the wide spread between bank loan rates and commercial paper rates, business loans could drop sharply in the months ahead, except for tax periods, unless business activity were to be very strong. A recent Standard and Poor's survey indicated that only 39 per cent of corporate bond offerings this year were intended to finance plant and equipment expenditures, compared with 63 per cent last year. The bulk of those funds apparently was to be used for working capital, refinancing bank loans, and building liquidity.

Mr. Scanlon noted that concern for liquidity continued to be reflected in changes both in bank asset portfolios and in liabilities. The reduction in loan-deposit ratios of major District banks since late 1966 had been quite small, on the average, with the biggest declines at banks with ratios exceeding 75 per cent. Loan ratios of many banks had continued to rise. Holdings of short-term Governments and money market loans in relation to deposits likewise did not indicate much improvement in liquidity. Nevertheless, "borrowed" funds, from whatever source, had declined substantially, and although a large volume of funds had gone into "other" securities, those had been mainly short-term municipal obligations and PC's of Government agencies. Moreover, since March the major time deposit inflows had been in the form of consumer-type CD's, which the banks regarded as much less subject to withdrawals than the negotiable type but less stable than savings deposits. The fact that the biggest banks still appeared somewhat uncomfortable about their liquidity positions and desired to be better prepared for seasonal demands later in the year seemed to militate against any near-term downward adjustments in either loan or deposit rates at those banks.

Mr. Scanlon agreed with the Manager that System operations in coupon issues had to be undertaken on a cautious basis. He would give the Manager ample latitude to operate in that area, but would discourage any feeling on the part of market participants that the Committee was now using a rate objective over the broad spectrum of maturities. It seemed to him that that was a very delicate business, particularly in view of the amounts the Committee was considering, and that it would require extreme skill and care on the part of the Desk in order to avoid giving the wrong signals to the market.

As to policy, Mr. Scanlon favored maintaining the prevailing conditions in the money market--which was called for by both alternatives for the second paragraph of the directive. If, as Mr. Swan suggested, it was desirable to make reference in the directive to operations in coupon issues, he would accept Mr. Swan's proposed language.

Mr. Clay said that, taking into account new data and revisions of earlier data, current evidence on the private economy and its near-term prospects was somewhat more restrained than at the time of the last meeting of the Committee. However, when that recent evidence was put into the larger prospective of economic forces at work and prospects for the balance of the year, and when account was taken of the stimulative actions of the System in the last six months, the monetary policy implications of the recent changes in economic information appeared to be small.

While the future pattern of economic activity could not be said to be clear, Mr. Clay continued, there was substantial reason to believe that the economy would be moving ahead much more actively in the third and fourth quarters of the year. Recent official statements pointed toward a significant increase in the stimulative thrust of the Federal budget. Moreover, the lull in inflationary pressures probably would be short-lived, not only because of demand and wage developments in the nonfarm sector but also because of increasing food and farm commodity prices. All factors considered, it would appear appropriate at this time to conduct a more moderately expansive monetary policy than in the early months of the year.

For the period immediately ahead, Mr. Clay thought maintenance of essentially the current money market conditions probably would be satisfactory. In that connection, it would be desirable if the Treasury bill rate did not fall below the levels of last week. The developments in long-term interest rates and the increasing spread between short- and long-term rates were matters of concern. That became particularly true as long-term rates once again approached levels that could have adverse effects upon the flow of funds to the credit markets relative to the savings institutions. While the demand for funds in the credit markets continued in its current volume, there was a real question as to how much could be accomplished by conducting open market operations in the longer maturities, at least without flooding the banking system with reserve funds. There probably would be some marginal impact upon both short- and long-term yields in using such operations in providing desired reserves, however, and under present circumstances that would appear to be in order.

Alternative B of the draft economic policy directives, with Mr. Swan's modifications, appeared satisfactory to Mr. Clay.

Mr. Wayne reported that business activity in the Fifth District had shown some small signs of improvement in recent weeks. Building permits rose substantially in April to the highest level since March 1966 and reports indicated modest gains in construction activity, while insured unemployment had declined marginally. Two large national companies had announced substantial reductions in the list prices of a wide variety of their man-made fibers. The optimism index of the Richmond Reserve Bank's survey panel was a shade higher than a month ago and now better than 80 per cent of the respondents expected stability or some improvement. New and unfilled orders remained weak but had perhaps improved a shade, while the pressure of inventories seemed to have moderated somewhat. The substantial cuts embodied in the recent tariff agreement would probably have a significant impact on the important textile and chemical industries in the District, but the fragmentary information presently available did not permit any accurate appraisal. District weekly reporting banks continued to be substantial sellers of Federal funds although they had been more active in expanding loans and total bank credit than city banks throughout the country.

At the national level, Mr. Wayne continued, the economy was operating at a high rate with near-full employment, despite several major adjustments which were the inevitable consequences of de-escalating an inflationary economy. In the somewhat calmer environment of recent weeks, monetary policy had been able to operate more effectively than in earlier periods. Well supplied with reserves from the earlier operations of the System, the banks had been able to meet their loan demand with little or no need to borrow. Short-term rates had been pushed down to or below the discount rate, but bank lending rates remained relatively high and sticky, while long market rates had been moving steadily higher. Those rates were matters of concern and if conditions were different it might be appropriate to return to a policy of aggressive ease. But several factors in the present situation gave him pause: the lack of improvement in the U.S. balance of payments and the possibility of a rapid deterioration in the country's international financial relations; the delayed effects of the large amounts of reserves the System had already supplied; the certainty of large but indefinite budget deficits; the uncertainty of any supporting fiscal action to restrain inflation if the need should arise; and the possibility of a quick return to an overheated economy. If the latter should develop it would be accentuated by the low level of unemployment. Since the country was not now facing a liquidity crisis, he did not believe it was necessary to supply reserves on the large scale of the first quarter. Rather, he would favor a policy which would encourage a moderate and sustainable growth in reserves and bank credit and he would hope that could be done without any great change in prevailing money market conditions. Also, he agreed with the suggestion in the blue book that in supplying reserves the Committee should emphasize as much as feasible the purchase of coupon issues, and therefore he preferred alternative B. Like Mr. Swan, he favored a proviso clause. He would accept all the amendments Mr. Swan had suggested, including the change in the first sentence of the directive.

Mr. Mitchell said that in his judgment the current heavy volume of capital market financing was probably all to the good--to the degree that corporations were improving their liquidity positions, increasing their working capital, and paying off debts--even though the large volume of financing had forced up long-term interest rates and provided some measure of financial restraint. He was still quite uneasy about the economic situation, but he thought his unease could be traced to the posture of fiscal policy, both last year and this year. More and more he had come to feel that early fiscal action was needed, not only for the reason Mr. Galusha had mentioned but also to deal with the problem of expectations and the problems of the real economy.

Mr. Mitchell noted that he was unhappy about the staff's reliance on the bank credit proxy as a policy guide. It was evident that banks could increase the degree to which they were intermediating if they wanted to; rate ceilings were not limiting their ability to obtain funds at present. But because corporations were repaying bank loans, loan demands were not strong and banks did not have an incentive to increase their intermediation. It was a mistake, he thought, to use as a criterion for policy a measure that was influenced by the extent to which banks chose to intermediate. About all the System should do in that connection was to try to dissuade the Home Loan Bank Board from rolling back the rate ceilings at savings and loan associations.

Thus, Mr. Mitchell continued, he thought the Committee's objective should not be formulated in the directive in terms of bank credit. In what terms should the objective be formulated? If long-term interest rates were used as a criterion, it would appear that there had been a great deal of restraint recently. But he did not think that the recent increases in long rates actually were imposing a large measure of restraint; rather, they reflected a kind of structural adjustment. He came back to the money supply as the criterion for policy. In his judgment, growth of the money supply in recent months had been adequate, if not generous, and he would not attempt to restrict it at this point.

That led him to favor about the same posture for policy--not much change--that most other speakers had advocated today. He favored System purchases of coupon issues for two reasons. First, with the large demand for bills at present, it would be desirable to avoid reducing the supply. Secondly, such operations perhaps would result in some moderation in long-term rates.

Mr. Daane said he had little to add to the staff materials and the discussion today of the economic situation. In his judgment, the cross-currents and uncertainties--which were well illustrated by the colloquy between Messrs. Mitchell and Koch following the latter's statement--pointed clearly to the desirability of an unchanged policy. While he (Mr. Daane) would not change policy today, he was concerned about the current and prospective balance of payments situation, and by the implications of the defense spending picture. The latter suggested an attempt to run a "guns and butter" economy, but he was skeptical as to whether that could be done without regenerating inflationary pressures. As Mr. Ellis had suggested, the Committee might be approaching the point at which it would be desirable to put more emphasis on caution and less on ease--that is, the point at which it might want to think twice about the risk of supplying reserves at a rate that might add to subsequent inflationary pressures.

Today, Mr. Daane said, within the framework of an unchanged policy he would favor emphasizing coupon operations in the manner and to the extent that the Manager had indicated, with full recognition that there was no intention of trying to alter market expectations regarding the level and pattern of interest rates. He thought coupon operations would be desirable not only in helping to relieve the market overhang, but, more importantly, in cushioning downward pressures on bill rates for balance of payments reasons.

Mr. Daane said he would go along with the thrust of alternative B of the draft directives. However, he did not favor the language reading "while moderating pressures in the capital market insofar as practicable" because it carried the connotation that the Committee thought it could move against the tide. He personally would prefer language reading, "while emphasizing operations in coupon issues in supplying reserve needs." That language would make it clear that purchases of coupon issues were to be made within the framework of reserve-supplying operations, and it did not carry any connotation that the Committee's operations by themselves could move the market or that the Committee was trying to do so.

Mr. Daane concluded by saying that he would not favor adding a proviso clause to alternative B, as Mr. Swan had suggested. He had been skeptical from the time the proviso clause was first introduced into the directive about the desirability of attempting to "fine tune" Desk operations to deviations of the proxy from expectations, and he continued to have that skepticism.

Mr. Maisel commented this was an unusual day. Mr. Daane had just made all the points he (Mr. Maisel) had wanted to make. He had intended to recommend a change in the language of alternative B along the lines of that Mr. Daane had suggested and he had also planned to speak against the proviso.

Mr. Maisel agreed that the present was a confused period with many types of cross-currents. That was a prime reason why he wished to support the policy outlined in alternative B, although he had some misgivings over the way it had been presented. It seemed to him the Committee need not adopt a long-term interest rate objective or even state its concern in terms of a problem of over-all pressures in the capital market.

First, Mr. Maisel said, he would like to stress the importance of maintaining a steady growth of credit to avoid distortions in the economy. The projections of bank credit growth, for the next six weeks and for the current fiscal year, were neither quite up to normal. There was no reason not to furnish a normal growth of total reserves. Granted that posture of continuing expansion, the System would have to furnish reserves during the coming period. Given the state of expectations in the market and the over-all objectives for the economy this year, a question arose concerning the logical place for those reserves to be injected.

It seemed clear to Mr. Maisel that the System should put the reserves into the long-term area rather than the bill area. In the bill area they would act mainly to force the bill rate down even further. Purchases would be competing in an area where the market, through its purchases, was showing its own strong preferences. On the other hand, if the System put them into longer-term issues, it would be aiding the market by supplying bills to help meet the market's desires for short-term liquidity. At the same time, the System would be decreasing the total of long-term issues, which the market said it was having trouble in digesting.

It might be noted, Mr. Maisel continued, that to do otherwise meant that the System would be continuing to shorten still further the average maturity of its portfolio, which already was a good deal shorter than in many past periods. The System had a large portfolio. That meant it had to determine its average length. To shorten it rather than to lengthen it would mean the Committee was adopting a portfolio policy opposite to its basic goals.

Also, Mr. Maisel said, by staying in the short end, the Committee might be increasing future problems. He was somewhat surprised that the question of a discount rate reduction had not been raised by those concerned with the technical relations between the bill rate and the discount rate. The gap below the discount rate was wider now than in over five years. Only in periods following two or more discount rate decreases in the past had there been a wider spread between the bill rate and the discount rate. Did technical relations hold in only one direction?

It seemed to Mr. Maisel that the proper policy was simply to continue the Committee's current reserve policy, while adopting a portfolio policy related to the market. The reserves necessary to insure a normal growth in bank credit should be furnished through purchases of long-term issues. The Committee would not attempt to set the interest rates in the long-term market but would not stop them from adjusting in accordance with the demand and supply forces which its portfolio adjustments created.

While he had frequently supported the inclusion of a proviso clause in past directives, Mr. Maisel said, he thought the Committee ought to avoid the use of the proviso unless it had a very firm policy goal to which it could be applied. He had no feelings at the moment that the Committee had a firm enough fix on liquidity requirements and the need for bank credit to recognize what a specific proviso should entail.

Since he believed that the directive should include the term "coupon issues" in it, Mr. Maisel supported the wording

Mr. Daane had proposed for that purpose. Coupon issues should be emphasized in furnishing reserves.

Mr. Brimmer said he favored alternative B for the directive with the wording regarding coupon issues that Mr. Daane had proposed. He would stress that he did not consider attempts to influence the level of long-term interest rates as "pegging" the market. He assumed that no one would want the Manager to engage in coupon operations in an aggressive way; he personally would favor supplying about half of the $500 million indicated reserve need through purchases of coupon issues, with those purchases spread over a period rather than made in a few days. It was important to keep in mind the likelihood that rising long-term rates would have an adverse effect on flows of funds to savings intermediaries. He noted that the staff's projection anticipated growth in residential construction of $2 billion in the third quarter, and that that expected increase accounted for roughly one-fifth of the increase in total private GNP projected for that quarter. He assumed that the percentage would be about the same in the fourth quarter. If such growth in GNP was to be achieved, it was clearly necessary to assure that the revival in housing was not aborted. The Committee could not accomplish that goal by itself but it could help, by moderating increases in long-term interest rates. It also was vital for the System to maintain a firm stand against proposals for reducing ceilings on savings deposit rates.

Mr. Brimmer said he would also ask the Committee, and particularly the Reserve Bank Presidents, to give further thought to the problem of restructuring reserve requirements of smaller banks. In visiting recently with Ninth District bankers he had learned that the Minnesota Act abolishing nonpar banking also authorized State banks to invest up to 30 per cent of their required reserves in earning assets. That would seem to represent quite a threat to Minnesota bank membership in the System, and the System should give thought to lightening the burden of membership on smaller banks by use of the authority it already had. He hoped that could be accomplished before it was precluded by a need for over-all credit restraint.

Mr. Sherrill said he went along with the majority view today favoring the continuation of prevailing money market conditions because, while he agreed that an upswing in the economy was likely, he was not sure about its timing. He favored alternative B for the directive, but with the two-way proviso clause added--again because of the existing uncertainties. He favored operations in longer-term issues, but would not get into the discussion of objectives because he agreed with various objectives that had been suggested. Basically, he would like to see the Committee use its operations in the longer-term market as constructively as possible, but he was not disturbed by the possibility that those operations would have some impact on long-term interest rates. He agreed on the need for caution. Perhaps coupon operations should be limited at this time to the $250 million figure that had been suggested, and the results evaluated before a decision was made to go further.

Mr. Hickman remarked that it was clear from information published since the last meeting that the business picture deteriorated in March and April, despite the optimistic expectations expressed by some participants at the Committee's meeting three weeks ago. In real terms, GNP for the first quarter was revised downward rather than upward, and private final sales were weaker than originally estimated. In April, a number of major economic series either were level or declined, including industrial production, new orders for durable goods, retail sales, housing starts, and factory payrolls. Thus, the over-all business picture was dominated by reports of declines or downward revisions in major cyclical indicators. For what it was worth, his staff estimated that real GNP, after declining slightly in the first quarter, would increase at annual rates of 1.3 per cent in the second quarter and 3.5 per cent in the third quarter. Those estimates were reasonably close--although suggesting slightly less vigor in the third quarter--to those presented in the green book, and to preliminary forecasts submitted by Fourth District economists, who would meet at the Cleveland Reserve Bank in early June. The figures indicated that the economy was in a fragile position, and would be operating below potential for several months.

Given that outlook, Mr. Hickman thought that monetary policy should be moderately accommodative, to facilitate the inventory adjustment and to provide the funds needed to finance the expected pick-up of residential construction. His own preference was to permit the aggregate reserve measures and the bank credit proxy to expand at an annual rate around 5 to 7 per cent, with free reserves fluctuating in whatever range was consistent with those objectives. In addition, he would continue to do what was possible to relieve uncertainties and pressures in the long-term bond market. He therefore favored alternative B for the directive, with Mr. Swan's amendment to the first paragraph and Mr. Daane's to the second.

As a matter of fact, Mr. Hickman said, a moderately accommodative monetary policy such as he had suggested would probably be appropriate for an indefinite period, if it were not for the fact that the Committee knew so little about the future magnitude of defense spending. It had been trying to sort out fact from rumor ever since the war in Vietnam escalated two years ago. If there was another major escalation, pressures would develop that would require a change in the mix of monetary and fiscal policy. In fact, a major escalation of defense spending could cause the type of overheating and financial stresses and strains that developed in the economy in late 1965 and 1966. At the present time, however, those were only conjectures; with the information now available, and with major economic indicators level or weaker, the Committee should do the best that it could to restore sustainable stable economic growth.

Mr. Bopp commented that it should be no surprise that business did not look quite so good now as three weeks ago. Adjustment of the economy to the tremendous inventory accumulation of the fourth quarter of last year could hardly be expected to proceed smoothly and continuously. Adjustment of statistics from preliminary estimates was also a fact of life that unfortunately had a greater effect on attitudes than it should.

However, Mr. Bopp said, after netting out the backing and filling, he came out about where he had been three weeks ago. The economy remained basically strong, as witness the relative steadiness of employment and unemployment. But, after some favorable news for March, weaknesses had been called to attention again by declines in retail sales and production during April.

For the fourth consecutive month, Mr. Bopp observed, signs of slack continued to dominate the economy of the Third District. Manufacturing activity was still weakening and final demand remained sluggish. Those signs might not adequately reflect the current climate since most District indicators were final only through March. Where April data were available, the rates of decline were slowing. That was evidenced particularly in manufacturing employment. In addition, total unemployment had made a favorable about-face by April.

Possibly reflecting those hints of an improved outlook, Mr. Bopp said, loan activity at Philadelphia banks in recent weeks had been increasing more than seasonally. Furthermore, expansion was expected to continue through fall. That expansion reflected (1) an expected pickup in economic activity, (2) some anticipatory borrowing by customers, and (3) expanded lines to small businesses under pressure from tax acceleration. Almost all of the bankers expected conditions to tighten as the summer progressed. Part of that would be seasonal, but part also reflected an expectation that economic activity was picking up. As yet, bankers had not been reluctant to extend larger credit lines or loans to new customers. Some, however, expected reluctance to develop.

Mr. Bopp remarked that events in recent weeks seemed to him to have clouded rather than clarified the outlook. One basic uncertainty--the extent and duration of the inventory adjustment--continued. A second--the degree of escalation of the war effort--had become more acute. Given those uncertainties, for the present he was inclined to mark time so far as policy was concerned. He was led to that conclusion also by developments in capital markets. The persistence of a large volume of new issues and the stubbornness of longer-term rates reflected a belief that pressures for funds were likely to build up again before long. For those expectations to be turned around, it probably would be necessary for the Desk to pump in very large amounts indeed. He would do whatever was possible by operations in coupon issues to keep long-term rates from rising, but would make no major move toward further ease.

That position was reinforced by the large current Federal deficit, Mr. Bopp said. If large deficits continued as the economy picked up in the latter part of the year, it might be necessary to pay close attention to the fiscal-monetary mix so as to avoid too much stimulation. Caution in easing too much now would help to achieve that objective.

For the directive Mr. Bopp favored alternative B, as modified by Mr. Daane, and with a proviso clause.

Mr. Kimbrel reported that economic conditions were spotty in the Sixth District. The latest manufacturing figures showed a further decline, as inventory adjustments continued to affect adversely the apparel, lumber, and furniture industries. However, the Sixth District, too, was beginning to see some ray of sunshine, which would indicate that a good many of those adjustments were behind it. He understood that very recently a large manufacturer of railroad equipment had been calling back employees, and that two steel mills were doing the same thing. While those reports might be only straws in the wind, they suggested that the visible statistics might not be an entirely accurate barometer of what was going on now. Automobile sales, on the other hand, were down about 10 per cent in April, after improving in March, and remained depressed in early May. A spot check of local bankers also revealed a decline in the demand for automobile and other instalment loans.

The biggest complaint of District farmers had been the weather, Mr. Kimbrel said. Drought conditions in Florida and South Georgia forced cattlemen to feed hay and citrus pulp to their cattle. The drought was especially severe in parts of Florida, which was finally blessed with rain late last week.

The same spottiness noted in business and agriculture carried over into banking, Mr. Kimbrel continued. Business lending, which showed a revival in the first half of April, slackened more recently, while other forms of lending improved. Here again, though, one should probably give as much attention to future prospects as to current developments. According to early indications gathered from the lending practices survey, many District bankers expected loan demand over the next three months to strengthen. Those prospects tied in with a considerable reluctance to reduce rates on savings certificates and with the practice of the large Atlanta banks of offering higher rates on CD's than banks in New York. That anticipation of a stronger loan demand was probably related in part to developments in the bond markets, which in the last two weeks caused an increase in discounts on FHA and VA mortgages in his area to 3-1/2 and 4 points.

Mr. Kimbrel said that he was, of course, quite aware that many of those same developments were taking place in other parts of the country as well, and that one could interpret them in different ways. But, to him at least, they suggested that monetary policy need not be as expansive now as it had been earlier in the year, although the spottiness of the statistics should caution against any sudden tightening. In fact, to stay about where the Committee was might be not only good economics but would also get applause from those academic economists who always favored a steady policy posture.

Mr. Kimbrel added that if he were expressing a preference for the directive it would be in the general direction of alternative B.

Mr. Francis said it appeared that the deceleration of economic activity had been halted, and that growth would soon be resumed. The increasing budget deficit of the Federal Government was providing a growing stimulus to the economy. Monetary actions had been very expansionary since early this year, and the response in the real sectors of the economy appeared to have been relatively quick. Since monetary and fiscal developments usually had their chief impact after some lag, the basic present problem was not how to achieve adequate total demand but how to avoid excessive demand.

A review of recent monetary developments indicated that they had been very expansive, Mr. Francis continued. In the past three months, total member bank reserves and nonborrowed reserves had risen at about three times their 1960-1966 trends. Federal Reserve credit and the money supply had risen at about double their trends, and commercial bank credit and money plus time deposits had risen about 50 per cent faster than their growth trends.

Mr. Francis thought an important concern now was that the System might overreact to the recent need for stimulation. It was necessary continually to keep in mind that actions had most of their effect after a lag. With total demand at a high level and likely to increase rapidly in coming months, with fiscal actions so expansionary, and with recent large increases in supplies of money and credit, he felt that this was the time to avoid overreacting to the pause in total demand of last fall and winter.

In formulating monetary policy for the future, Mr. Francis remarked, an effort should be made to visualize economic conditions as they would be when the Committee's actions became most effective.

Projections presented in the green book indicated marked increases in demands for goods and services and in real GNP for the balance of the year. The decline in real GNP from the fourth quarter of 1966 to the first quarter of 1967 represented only a slight deviation from the growth path of high employment output. Recent Administration statements regarding the fiscal outlook for the rest of the year indicated, even if the 6 per cent surtax was passed, a growing net stimulative thrust to the economy from the Federal budget. With that prospect, excessive inflation was likely to appear later in the year unless monetary actions were moderated now.

Mr. Francis said the Committee should profit from last year's interest rate experience. By limiting interest rate increases in early 1966, the stage was set for the severe restraint required last summer. Forecasts of a growing Government deficit with large Treasury borrowing and continued heavy private demands for funds portended upward pressures on interest rates. System actions based on a desire to offset those pressures would provide loan funds in excess of planned saving. Such accommodating actions would lead once again to a need for severe restraint later in the year, with possible repetition of the market dislocations of 1966. If the fundamental situation was such that the Federal Government and the rest of the economy combined were going to demand more funds than planned saving at current rates, only inflation could follow from attempts on the Committee's part to hold down long-term interest rates. Since there was a reasonable prospect of renewed inflation, the Committee should move at this time to reduce its stimulative force on total demand.

As to immediate policy, Mr. Francis believed the blue book's projected increase of money at an 8 to 11 per cent annual rate from May to June would be too rapid. He recommended a growth in money over the next three months at a 2 to 4 per cent rate. Or, in terms of total bank credit, a three-month growth rate of 5 to 7 per cent would seem appropriate. To that end, he recommended an acceptance of a firming of capital market yields. In addition, he believed some firming of the money market might be necessary to moderate the expansion of money and bank credit.

It was Mr. Francis' belief that the proviso clause in the directive had been useful to the System in reaching its proximate objectives more quickly, while not reducing its effectiveness in day-to-day operations in the money market. In view of the difficulties of selecting a money market target that would provide a desired growth in the Committee's proximate measures, a proviso clause seemed to be imperative for the effective implementation of Committee policy.

For the second paragraph of the directive, Mr. Francis favored language reading, ". . . System open market operations until the next meeting of the Committee shall be conducted with a view to achieving some firming in the money market, but operations shall be adjusted as necessary to moderate any deviations of bank credit expansion from a 2 to 6 per cent range."

Mr. Robertson made the following statement:

> I think we need to recognize that there is a certain amount of uneasiness in the air these days--for reasons which, if taken at face value, would have quite different implications for policy. There is uneasiness over the short-fall of recent business statistics below the most optimistic expectations of a few weeks ago. There is uneasiness about the state of the bond markets, with prices falling under the weight of the seemingly endless parade of corporate and municipal demands. Most of all, a deep-rooted uneasiness exists concerning the course of the war in Vietnam, and the chances that it may add still further to an already powerful but somewhat artificial fiscal stimulus to business activity.
>
> Some of these reasons might seem to argue for an easing of policy, while others might seem to support a tightening. In this kind of situation, I think the right posture for the Committee is to do neither. This is not the time to let particular developments cause us to become jumpy or panicky. Expectations can swing widely, and trying to follow along behind them with counteracting policy changes can simply lead to still greater fluctuations in economic and financial performance.
>
> As a matter of fact, a good many of the forces at work today ought to partly compensate for one another, and the expectation which seems to me most likely to prove correct is for a resumption of vigorous economic advance later in the year. Accordingly, I think the wisest policy decision right now would be to hold a steady course, keeping the money market reasonably

comfortable, and allowing the adjustments still in process to proceed in an orderly fashion.

Even within such a policy of "no change," however, almost everyone who has spoken today believes there is room for added attention to the long-term markets--that we should give more support to the bond market. At the risk of sounding like a broken record, let me say again that I think this is an area of operations of which the Federal Reserve should be very wary. The benefits, it seems clear, are not very large or very certain, and the costs in terms of market interference can easily outweigh them.

I do not mean to argue that the System should never intervene in the market for coupon issues. I recognize that there can be a turn of events in which a major overhang of securities inventories is virtually choking the market, and in that circumstance a decisive (and adequately explained) official move to buy up the excess supplies in one swift succession of operations may be the wisest course. But stepping in to buy up bonds when the market is in less extreme difficulties, if it is repeated often enough, will tend to reduce the market's self-reliance, its capacity for responsible behavior, and its ability to index and to balance changing demands and supplies of funds. Granted that the Manager might well be able to complete some particular buying action neatly, the hidden cost of any succession of such operations may be expected to unfold over the longer run in terms of a potentially less effective market performance. I, for one, would rather not pay that cost when it can be avoided.

For these reasons, I am in favor of alternative A for the directive as drafted by the staff, particularly with its two-way proviso clause focused on bank credit. Recognizing that June is likely to be a month of considerable financial churning, however, I would encourage the Manager to wait for somewhat larger deviations from expectations than he would ordinarily look for, especially on the upside, before bringing the proviso into play.

Chairman Martin said he sympathized with Mr. Robertson's views on System operations in the long-term market; his position on that subject through the years was well known. But the Committee had taken another course for some time, and he thought it should be prepared to play its hand out. Accordingly, he had no objections to coupon operations at this time. Much depended on how skillfully they were carried out, and he thought the Committee could rely on the Manager in that connection. If such operations were to be undertaken, he would favor referring to them in the directive, as was done in alternative B.

The Chairman noted that the Committee was not unanimous on policy today, with Mr. Francis favoring some firming of money market conditions and the remaining eleven members favoring the maintenance of prevailing conditions. Also, a number of suggestions had been made for revising the language of the draft directive. He suggested that the Committee try to arrive at a directive that was acceptable to the majority, with Mr. Francis to be recorded as dissenting if he so desired.

In discussing the directive, the Committee first considered the various suggestions that had been made for revising the staff's draft of alternative B for the second paragraph. Mr. Mitchell indicated that he would rather not have the proviso clause included in the directive at this time. Messrs. Brimmer and Treiber concurred, and Messrs. Daane and Maisel noted that they had expressed a similar view in the course of the go-around.

Chairman Martin said that he also would prefer to omit the proviso clause, which he had never liked much in any case. He asked whether there was any disagreement on the proposal to omit it.

Mr. Wayne commented that he still had the preference for including the clause that he had expressed earlier, but he was not prepared to vote against the directive if the majority wanted to omit it.

Mr. Swan indicated that he also preferred to retain the clause. He noted that the broader question had been raised of whether the directive should include a proviso clause generally. He would be highly reluctant to see the clause abandoned, and he hoped the Committee would discuss the broader issue at some point.

Mr. Maisel commented that as a general rule he preferred to have a proviso clause in the directive, but thought that this was not the right time for it since the members were not of one view on how it should be formulated.

Mr. Mitchell remarked that the present seemed to be a singularly inappropriate time to include a proviso clause.

Chairman Martin commented that he would prefer to eliminate the clause in general, but his position on the issue was not hard and fast.

The discussion then turned to the formulation of the phrase relating to operations in long-term markets, for which Messrs. Swan and Daane had both proposed language different from that in the staff's draft.

Mr. Robertson said he could vote for Mr. Swan's suggested language, calling for "moderating unusual pressures in the capital market." He could not vote for a directive which, as Mr. Daane had proposed, called for "emphasizing operations in coupon issues in supplying reserve needs."

Mr. Daane said he thought it was the majority view that the phrase "while moderating unusual pressures in the capital market" would suggest that the Committee was seeking to go further than it in fact wanted to. The phrase he had suggested struck him as more straightforward because it indicated that coupon operations were to be conducted in the context of supplying reserve needs, and he believed it was more nearly consistent with the majority view.

Mr. Swan said he had no particular pride of authorship in the phrase he had proposed, and had no objection to the general thrust of Mr. Daane's suggested language. But he thought the word "emphasizing" was too strong. Perhaps a more neutral word could be found.

Chairman Martin then suggested using the word "utilizing" rather than "emphasizing."

Mr. Daane agreed that that substitution would be appropriate. He added that it might also be desirable to include the words "part of" before "reserve needs." The phrase would then read, "while utilizing operations in coupon issues in supplying part of reserve needs."

In response to the Chairman's request for comment, Mr. Holmes said it appeared from the go-around that most members were agreed that coupon operations would have to be conducted cautiously, and comment also had been made to the effect that the Desk should have latitude to curb operations in coupon issues if they appeared to be leading to difficulties. He thought the word "utilizing" was more neutral than "emphasizing," and thus preferable.

With respect to the first paragraph, the Committee agreed to adopt Mr. Swan's suggestion to insert the phrase, "later in the year" in the opening sentence, between "renewed economic expansion" and "is in prospect."

Mr. Mitchell then proposed that the second sentence be revised to read: "Output is still being retarded by adjustments of excessive inventories, but with no interruption in the sharply rising trend in Government outlays now in sight the prospect is for stronger growth in aggregate final demands."

Mr. Koch commented that the language Mr. Mitchell had proposed did not appear consistent with the staff projections of a declining rate of increase in Federal defense spending. Such spending, which had risen at a rate of $4.2 billion in the first quarter, was projected to increase at rates of $3 billion in the second quarter and $2.5 billion in the third.

Mr. Wayne said he would favor the language Chairman Martin had suggested earlier, following Mr. Mitchell's comment on the second sentence in the course of the go-around.

Other members concurred in Mr. Wayne's observation.

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

The economic and financial developments reviewed at this meeting suggest that renewed economic expansion later in the year is in prospect. Output is still being retarded by adjustments of excessive inventories, but growth in final demands, particularly Government, continues strong. Average wholesale prices have declined recently, but unit labor costs in manufacturing have risen further. Bank credit expansion has slowed in recent weeks from its earlier rapid rate. Long-term interest rates have continued to rise under the influence of heavy securities market financing, but short-term yields have declined further. Some further reductions have been made in foreign central bank discount rates. The balance of payments deficit has remained substantial despite some improvement in the foreign trade surplus. In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions, including bank credit growth, conducive to renewed economic expansion, while recognizing the need for progress toward 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 conditions in the money market, while utilizing operations in coupon issues in supplying part of reserve needs.

Chairman Martin then observed that the Committee had planned to continue its discussion today of the implications for its procedures of the "Freedom of Information Act." He noted that certain additional materials bearing on the matter had been distributed since the preceding meeting. These included a memorandum to the Committee from Mr. Hackley dated May 16, 1967, entitled "Rules regarding availability of information," and a memorandum to the Committee from the staff dated May 17, 1967, entitled "Proposed availability of records relating to domestic open market operations at the Federal Reserve Bank of New York under the Freedom of Information Act." Also, at his (Chairman Martin's) suggestion, on May 22 the Secretary had distributed copies of a memorandum with certain attachments that Mr. Hackley had addressed to him on May 8, 1967. That memorandum, entitled "The Federal Open Market Committee and the Freedom of Information Act," was concerned primarily with the question of seeking an executive order exempting the Committee's records from disclosure.[1] The Chairman then asked Mr. Hackley to open the discussion.

Mr. Hackley said he thought the most important question immediately before the Committee was that raised at the preceding meeting, relating to a possible executive order exempting all of the records of the Committee. Before turning to that question, however, he would touch briefly on certain other matters. First, last Wednesday the Legal Division had received from the Department of Justice, with a request for comments by last Friday, a revised draft of the Manual providing guidelines for Government agencies in implementing the Freedom of Information Act. The revised draft, in his judgment, was an improvement over the earlier draft. For example, it contained a specific statement to the effect that records of deliberations of an agency were completely exempt from disclosure under the Act. In that connection, he would recommend that the Committee approve a division of the documents traditionally known as the "minutes" into two documents: one, a record of actions taken, to be called "action minutes" and to be made available on a deferred basis; and the other, a record of the Committee's discussions, which would be exempt from disclosure. The Legal Division's comments on the

1/ Copies of the various documents referred to have been placed in the files of the Committee.

revised draft of the Manual were concerned principally with the desirability of clarifying the point that materials which were not exempt from disclosure might nevertheless be disclosed on a deferred basis, where some time lag was necessary to avoid impairing an agency's operations. In his judgment the law could be construed to permit such time lags, but it would be helpful to have the point clearly stated in the Manual.

Mr. Hackley noted that with his memorandum of May 16 he had submitted a draft of proposed new Committee Rules regarding availability of information. He recommended that the draft be approved, subject to any necessary technical or editorial changes and subject to the Committee's final determination with respect to the length of the time lag for publication of its directives and authorizations. He would continue to recommend a time lag of 60 rather than 90 days simply because the shorter period seemed to comply more clearly with the requirement of the Act that statements of general policy be published "currently." However, he thought that a lag of 90 days would be defensible, if that turned out to be the Committee's preference.

As the draft of the new Rules was formulated, Mr. Hackley continued, it not only provided for specifying the lag with which the Committee's directives and authorizations would be published, but also indicated that certain unpublished records would be made available to the public with such time lags as the Committee might decide upon. For example, the Committee could approve a schedule indicating particular time lags--1 day, 8 days, 30 days, or whatever--with respect to the availability of particular records, relating to open market operations, that were held at the Federal Reserve Bank of New York. A proposed schedule of that type was attached to the staff's memorandum of May 17. The schedule listed only documents relating to domestic operations, but a similar list could be prepared for documents relating to foreign currency operations.

Turning to the question of an executive order, Mr. Hackley recalled that at the previous meeting he had been directed to prepare a letter to the Department of Justice asking for such an order exempting the records of the Committee relating to both domestic and foreign currency operations. A draft of such a letter had been prepared, and a copy was attached to his memorandum to Chairman Martin of May 8 that had been distributed to the Committee. However, he continued to feel strongly that it would be unwise and unnecessary to seek an executive order such as that contemplated by the draft letter, providing for exemption of all records of the Committee. In his judgment it would be preferable for the Committee to take the position that in complying with the letter and spirit of the law it would lean over backward to make available all records for which that was practicable; and, where absolutely necessary to avoid impairment of its operations, it would rely upon the statutory exemptions. He believed, and he understood that the legal staff of the New York Bank agreed, that practically all of the Committee's records either were exempt from disclosure under the Act or could be made available on a deferred basis. It was his personal judgment that the Committee would not find itself faced with any serious problems if it did not obtain an executive order.

As he had mentioned at the preceding meeting, Mr. Hackley said, the Treasury Department had requested an executive order exempting its records relating to foreign currency operations. They had indicated that their first preference was for an amendment to the 1953 executive order regarding classification of defense information, making it clear that the term "defense information" embraced economic, financial, and monetary matters bearing on U.S. relations with foreign governments. Their second choice was for a separate executive order covering their foreign currency operations.

If the Committee were to obtain an exemption for its own foreign currency operations, Mr. Hackley observed, in his opinion the procedure of amending the defense information executive order to grant that exemption would lead to many problems. The order contained detailed and rigid requirements regarding classification and declassification of documents, handling of classified documents, clearances of personnel, and so forth, that would prove burdensome. It also would be necessary for the Committee to request authorization to make original classifications of defense information under that order; while the Treasury had such an authorization at present, neither the Committee nor the Board did. Accordingly, if the Committee were going to ask for an executive order, he believed it should request one that was separate from the defense order.

On checking with the Treasury this morning, Mr. Hackley said, he had learned that as yet they had had no reaction from the Department of Justice to their request, which had been made by letter on April 21. At this point, therefore, it was by no means certain that the Treasury would obtain an executive order exempting their foreign currency records. If the Committee wished to have the matter pursued further, it might authorize the staff to talk with the Treasury staff about coordinating the System's and Treasury's approaches to the matter more closely, and to hold discussions with the appropriate people in the Justice Department.

Mr. Maisel noted that the next item on the Committee's agenda today concerned policy with respect to publication of information on drawings under the swap network and on other System foreign currency operations. He asked Mr. Hackley to comment on the relation between the proposed new Rules and decisions on such questions.

Mr. Brimmer said he had a similar question. The item Mr. Maisel had mentioned had been placed on the agenda following a discussion by the Board of a draft of the Special Manager's report for 1966, prepared for inclusion in the Board's Annual Report. One of the points discussed, he recalled, was a request by the Bank of Canada that information not be published at that time regarding a drawing they had made during the year under their swap arrangement with the System. How would such situations be handled under the proposed new Rules?

Mr. Hackley replied that his recommendation would be that the Committee rely in such cases on a reasonable construction of the statutory exemptions, as the Justice Department's draft Manual suggested. In his opinion one or more of the statutory exemptions could be construed to cover information relating to operations under a swap agreement. Legally, swap drawings were borrower-lender transactions, and it was clear from the draft Manual that information on such transactions was exempt.

In reply to Mr. Maisel's question about the status of information concerning negotiations of swap agreements and Committee discussions on that subject, Mr. Hackley said he thought it was clear that such information would be exempt.

Mr. Treiber said he would suggest that the Federal Reserve seek promptly an exemption from the Freedom of Information Act of

Committee records pertaining to foreign currency transactions. He had hoped that the Treasury would join in a similar request seeking the exemption of Treasury records pertaining to foreign currency transactions.

As regards Federal Reserve foreign currency transactions, Mr. Treiber continued, all such transactions, whether initiated by the Federal Reserve or the foreign central bank, involved a confidential relationship between the System and the foreign central bank. The System should not reveal to the public on an automatic basis information involving such a relationship. Operations on System initiative were undertaken to defend the dollar, a purpose that could be frustrated by premature disclosure. Similarly, a foreign central bank might find its purposes frustrated by premature disclosure. Unless arrangements, such as the swap arrangements, were mutually advantageous, the partnership could fall apart. The foreign partner might not care to be a partner if the American partner was committed to disclosure of the transactions on an automatic basis and not on a basis of mutual discussion and a weighing of the interests of the parties.

Mr. Treiber noted that the Federal Reserve Bank of New York conducted similar transactions for the System and for the Treasury. Sometimes the transactions were alike and simultaneously executed with the same foreign entity. Clearly, administration would be much simpler at the Federal Reserve Bank of New York if the basic disclosure rules were similar. If the Treasury transactions were classified as "confidential" or "secret" under the 1953 executive order relating to defense information, and the Federal Reserve transactions were a quite different affair, the difficulties would be many. If the Federal Reserve transactions were considered "secret" defense information, there would be a whole new array of problems.

He trusted, Mr. Treiber continued, that there could be parallel treatment affording an exemption to records regarding foreign currency transactions by the Treasury and such transactions by the Federal Reserve. He trusted that that treatment could be provided for by an executive order addressed specifically to foreign currency transactions. He would consider it unwise to treat such transactions as secret defense material with all the cumbersome procedures and red tape associated with such a classification.

Mr. Hackley noted that the Treasury thought a separate executive order might involve difficulties in that it would be necessary to include a specific enumeration of all categories of information for which secrecy was required in the interest of national defense or foreign policy. But there was no such enumeration in the existing defense information order, and he did not believe one would be necessary in a separate order. The latter in general could parallel the defense order except with respect to the detailed requirements for handling classified materials. The separate order might simply say that information of the Committee relating to foreign currency operations would be exempt from disclosure to the extent that the Committee determined was necessary.

Mr. Maisel asked whether Mr. Hackley thought there would be any substantial difference in the Committee's procedures if it did or did not obtain an executive order exempting information on its foreign currency operations.

Mr. Hackley replied that in his judgment the Committee's procedures could be substantially the same whether or not it obtained such an order, on the assumption that the Act permitted a time lag in disclosing information in cases where premature disclosure would impair performance of its statutory functions.

Mr. Brimmer asked whether Mr. Hackley was saying that in the absence of an executive order the Committee could defer release of some information relating to foreign currency operations, but would have to make all such information available at some point.

Mr. Hackley replied in the negative, noting that most such information would be completely exempt from disclosure in any case.

In response to the Chairman's request for comment, Mr. MacLaury said that, while not prejudging the next item on today's agenda, the goal with respect to information on foreign currency operations as seen by the staff concerned at the New York Bank was to avoid being forced to disclose more than was currently being disclosed as a matter of public policy. Although Mr. Hackley had suggested that obtaining an executive order exempting foreign currency information would make little difference, he would urge that such an order be sought. Of the nine specific exemptions listed in the Act the first, relating to information required to be kept secret in the interest of national defense or foreign policy, seemed most closely applicable to the System's foreign currency operations; but under the language of the Act it could not be relied on unless an executive order was obtained. He agreed that if such an order was sought it would be preferable to have it separate from the existing defense information order, and that it would be desirable to have System and Treasury foreign currency operations treated in parallel fashion.

Mr. Daane commented that the Treasury's request for an executive order suggested that they thought one was necessary.

Mr. Hackley agreed that that might be the case. He added that one possible approach would be to seek a single order covering foreign currency operations of both the Treasury and the System.

Mr. Brimmer asked whether the Treasury was relying on the "Trading with the Enemy Act" in the present connection, and Mr. Hackley replied that he had no reason to think so.

Mr. Robertson asked whether there was any time limit within which an executive order had to be sought. If not, the Committee might authorize the staff to consult with the Justice Department while waiting to see what disposition was made of the Treasury's request for an order. If the latter was approved, the Committee could seek an equivalent order at a later date.

Mr. Treiber said he would be disturbed if an exemption was granted in the manner the Treasury had suggested--by an amendment to the defense information executive order--since the procedures for handling materials under that order were cumbersome. He thought it would be desirable, before action was taken on the Treasury's request, to try to get a separate order, of simpler form, covering both Treasury and System foreign currency operations.

Mr. Daane asked whether the question of the probable response to such a request had been explored with the Department of Justice.

Mr. Hackley replied in the negative, noting that the Legal Division had felt that it should have definite authorization from the Committee before pursuing the matter with the Justice Department. As he had indicated earlier, however, he thought that such explorations might be desirable.

Chairman Martin said the Committee might authorize Mr. Hackley to explore all aspects of the matter with the Treasury and Justice

Departments and report back at the next meeting, on June 20. It would be necessary to reach decisions by that time since the Act became effective on July 4.

The Chairman went on to say that he had discussed the matter with a number of people, including the Attorney General. The more he had thought about it the more he had come to hope that the Committee would not permit itself to appear to be dragging its feet in releasing information that was of legitimate interest to the public. On reviewing the Committee's minutes recently, he had become increasingly convinced that its domestic operations would not be disturbed if the current policy directives were to be published with a 60-day lag--and certainly not if the lag was 90 days.

Mr. Daane noted that he would not be able to attend the Committee meeting on June 20 and accordingly would like to pursue the matter further today. While he was not opposed to providing information to the extent feasible, he was concerned about the possible effects on the Committee's operations and he was not convinced that there would not be the risk of considerable loss of effectiveness unless the Committee was able to retain maximum flexibility with respect to the release of information. He agreed that exploratory discussions should be held to the extent possible, but he would be disturbed if decisions were put off until June 20, when there might be fewer options left open.

Mr. Brimmer noted that he had made a similar point in the discussion at the previous meeting. He suggested that the Committee not confine itself to asking Mr. Hackley to explore the question of an executive order exempting information on its foreign currency operations. The Secretary of the Treasury might also be asked to seek postponement of action on the Treasury's request for an exemption until there was an opportunity to review the question with the Secretary and to work out a coordinated approach to foreign currency operations.

Mr. Brimmer said he had changed his position somewhat since the previous meeting. He was now prepared to drop his earlier suggestion for seeking an executive order exempting information on domestic as well as foreign currency operations, on the assumption that the Committee would agree to a lag of 90 days for releasing its directives. He was opposed to a 60-day lag.

Mr. Wayne noted that there appeared to be general agreement on the desirability of obtaining an exemption for information on foreign currency operations by executive order. He suggested that the Committee authorize Mr. Hackley to discuss a coordinated approach with the Treasury, on the understanding that if that did not prove feasible he would be authorized, without reporting back to the Committee, to request a separate executive order covering System foreign currency operations.

Mr. Maisel remarked that in his judgment an executive order indicating that information on foreign currency operations in general--that is, both those of the System and the Treasury--were required to be kept secret in the interest of foreign policy was preferable to an order directed to the System's foreign currency operations alone.

Chairman Martin said that he and Mr. Robertson might undertake to act for the Committee in connection with foreign currency information. He would much prefer not to have the Committee seek an exemption covering its domestic operations.

Mr. Daane observed that if that was the position of the Committee--and he continued to have reservations regarding its appropriateness--he would share Mr. Brimmer's feeling that the lag in releasing the directives should be 90 rather than 60 days.

Mr. Maisel commented that if the Committee agreed on a 90-day lag today, it might plan on publishing its policy record entries for the first quarter of 1967 on June 7, 90 days after the March 7 meeting.

Chairman Martin remarked that such a publication date would be so close to the July 4 effective date of the Act that he could see little gain in anticipating the effective date.

Mr. Brimmer said that whether or not the Committee planned to publish its first-quarter record in June, it was important to reach a decision on the lag soon so that the staff would be able to move ahead in preparing for publication. He hoped that decision could be taken today.

Mr. Daane agreed. He added that he had some questions regarding the list of documents relating to the operations of the Desk, attached to the staff memorandum of May 17, that were proposed for release with various time lags. He personally was not prepared to accept the list at this juncture. He asked whether Mr. Holmes was satisfied with it.

Mr. Holmes replied that the list in question omitted a number of types of records at the New York Bank relating to operations of the System account. While the Bank's legal staff believed that those documents were exempt under the Act, it was not certain that a court would agree. If it became necessary to disclose them the question would be whether the lag permitted was sufficiently long to prevent damage to operations.

The Chairman then asked whether the members would indicate whether they would prefer a 60- or a 90-day lag for release of the directives, noting that he personally favored the shorter lag.

Messrs. Swan and Wayne expressed a preference for a 60-day lag, with the latter adding that he nevertheless would not object to 90 days.

Mr. Maisel said he thought a 60-day lag probably would be preferable, but he would be willing to start with a 90-day lag and consider shortening it later since it would be far easier to shorten to 60 days than it would be to extend the delay if the initial choice turned out to be inappropriate.

Mr. Mitchell observed that in his judgment a 60-day lag probably would be adequate in the great majority of cases. However, since a 90-day lag might be desirable occasionally, he would prefer that the longer lag be used on a regular basis.

Messrs. Brimmer and Daane commented that they felt strongly that the lag should be 90 days. Mr. Brimmer then asked if the Manager would comment on the question.

Mr. Holmes said he agreed with Mr. Mitchell that a 60-day lag for releasing the policy directive might ordinarily not be damaging, but that a 90-day lag might be preferable for the reason Mr. Mitchell had mentioned.

Chairman Martin then commented that the question of the appropriate time lag seemed sufficiently important to warrant more study. Accordingly, he proposed that the Committee defer a decision on it until its next meeting. It was unfortunate that Mr. Daane would not be present at that meeting, but if he so desired he could distribute a written statement of his views in advance.

Mr. Wayne noted that Mr. Hackley had made certain recommendations which appeared to be noncontroversial, and on which the Committee might act today. One such was the recommendation that the Committee's minutes be divided into action minutes and records of discussion.

Chairman Martin asked whether there was any objection to approving Mr. Hackley's recommendation concerning the minutes, and none was heard.

Mr. Hackley asked whether the Committee was prepared to approve the draft of new Rules regarding the availability of information on a tentative basis.

Mr. Treiber remarked that any such approval presumably would be in principle, with the language of the Rules subject to any changes of detail that might be found desirable after further study.

Chairman Martin said it appeared that the Committee was prepared to approve the draft rules on that basis. The Chairman then remarked that the Committee obviously had some difficult decisions to make in connection with the Freedom of Information Act, but he would reiterate his hope that it would not get into a position of seeming to be reluctant to release information to the public. A great deal of progress had been made in recent years in demonstrating that the Committee was not trying to operate in total secrecy. In cases where secrecy was important it should be preserved, but those who favored more disclosure had a good deal of support and he thought the System would be better off if it furnished as much information as possible.

The Chairman then suggested that in view of the hour the Committee postpone discussion of the final item on the agenda, relating to policy on information regarding swap drawings and other System foreign currency operations.

There was no disagreement with the Chairman's suggestion.

It was agreed the next meeting of the Committee would be held on Tuesday, June 20, 1967, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

CONFIDENTIAL (FR)

May 22, 1967

Drafts of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on May 23, 1967

FIRST PARAGRAPH

The economic and financial developments reviewed at this meeting suggest that renewed economic expansion is in prospect. Output is still being retarded by adjustments of excessive inventories, but growth in aggregate final demands continues strong. Average wholesale prices have declined recently, but unit labor costs in manufacturing have risen further. Bank credit expansion has slowed in recent weeks from its earlier rapid rate. Long-term interest rates have continued to rise under the influence of heavy securities market financing, but short-term yields have declined further. Some further reductions have been made in foreign central bank discount rates. The balance of payments deficit has remained substantial despite some improvement in the foreign trade surplus. In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions, including bank credit growth, conducive to renewed economic expansion, while recognizing the need for progress toward 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 conditions in the money market, but operations shall be modified as necessary to moderate any apparently significant deviations of bank credit from current expectations.

Alternative B

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the prevailing conditions in the money market, while moderating pressures in the capital market insofar as practicable.