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, October 4, 1966, at 9:30 a.m.

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

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

Messrs. Ellis, Patterson, and Galusha, Presidents of the Federal Reserve Banks of Boston, Atlanta, and Minneapolis, respectively

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

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

Messrs. Eisenmenger, Ratchford, Taylor, Baughman, Jones, and Craven, Vice Presidents of the Federal Reserve Banks of Boston, Richmond, Atlanta, Chicago, St. Louis, and San Francisco, respectively
Mr. Geng, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Kareken, Consultant, Federal Reserve Bank of Minneapolis

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on August 23 and September 13, 1966, were approved.

Under date of September 16, 1966, there had been distributed to the members of the Federal Open Market Committee copies of the report of audit of the System Open Market Account and of the report of audit of foreign currency transactions, both made by the Board's Division of Examinations as at the close of business May 13, 1966, and submitted by the Chief Federal Reserve Examiner under date of June 17, 1966. Copies of these reports have been placed in the files of the Committee.

Upon motion duly made and seconded, and by unanimous vote, the audit reports were accepted.

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign

currencies for the period September 13 through 28, 1966, and a supplemental report for September 29 through October 3, 1966. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Coombs said that the Treasury gold stock would remain unchanged this week. The Stabilization Fund now had about $100 million of gold on hand, with prospective sales during the month of October of roughly $75 million. On the London gold market, buying pressure was consistently heavy during September and the original $270 million in the gold pool was further depleted by another $54 million, to no more than $12 million. As the Committee would recall, a supplement of $50 million to the gold pool had been negotiated at the September Basle meeting, and if necessary another $50 million could probably be secured although that might well be the end of the line. While some slackening in the demand for gold might be seen now that the Fund and Bank meetings were over, he continued to think that the gold market constituted the single most dangerous threat to the dollar.

On the exchange markets, Mr. Coombs continued, there had been a gradual improvement in confidence in sterling since the announcement of the increase in the swap lines on September 13. During the first 13 days of September the British were still

running a sizable deficit which, in the absence of the increase in the swap network, would probably have reached major proportions during the second half of the month. The turn in the tide over the past two weeks had enabled the Bank of England to announce this morning a reserve increase for the month of three million pounds, while also indicating that no net recourse to central bank credit was made during the month. As the Committee would recall, the Bank of England had outstanding on August 31 $625 million of overnight money, of which $450 million was provided by the Treasury and Federal Reserve and $175 million by certain foreign central banks. The position at the end of September was somewhat improved although still vulnerable. The overnight money component had been reduced from $625 million to $375 million, comprised of $200 million from foreign central banks and $175 million from the Treasury. The remaining gap of $250 million had been covered by a $150 million drawing on the agreement negotiated in Basle last June providing for financing of reductions in the sterling balances, while another drawing of $100 million of three-month money was made on the Federal Reserve. It was to be hoped that today's announcement that the reserve drain was stemmed during September, which had been anticipated to some extent in the market, would further restore market confidence. Yesterday, the Bank of England took in more than $30 million and this morning

they had already taken in an additional $50 million, so the signs were accumulating of a return of confidence. He would hope to see a string of reserve increases over the weeks to come.

The other major development in exchange markets, Mr. Coombs observed, had been the gyrations of the French franc, which on several days slipped below par. The Bank of France did not seem to be making any special effort to check the rate movements and, as far as he could tell, the recent selling pressure on the franc seemed mainly attributable to such short-term phenomena as money market pressures, an adverse tourist balance, and similar temporary developments. On the other hand, he thought it possible that there might be some swing of the leads and lags against the French franc. The French had benefited enormously over the years from the view that the French franc could not possibly be devalued, so that importers did not find it necessary to cover their dollar requirements. That situation might now be turning as the markets reappraised the long-term prospects for the currency of a country which had increasingly cut itself off from the cooperative arrangements developed among the other major industrial countries.

Mr. Mitchell asked what Mr. Coombs thought was the effect on the British position of the pull-back of Euro-dollar funds through foreign branches of U.S. banks.

Mr. Coombs replied that the effect had definitely been adverse for two or three months, although he did not know the extent to which it had resulted in British reserve losses. At the same time, the pressures exerted on sterling by the operations of American banks had simultaneously been exerted on all major continental currencies. He would assume that the pull-back of funds was an important factor in the third-quarter surplus in the official settlements balance of the U.S. It also had important implications for the U.S. gold stock.

Mr. Mitchell then asked whether Mr. Coombs thought the British would experience difficulties if U.S. banks continued, for the next four or five months, to draw in funds through their branches at the recent rate.

Mr. Coombs replied that such a development undoubtedly would slow the pace of the British recovery. His own impression was that the pull had been a little too strong in some periods recently, but if it were stopped entirely the loss to the U.S. would be greater than the gain to the British.

Mr. Shepardson asked whether a significant share of the funds being drawn in through U.S. bank branches was coming from the continent.

Mr. Coombs replied that he thought the main pressure exerted on sterling by the pull-back had occurred in July and

August, and that such pressure had lessened in September. He would be surprised if at present as much as 20 per cent of the funds were coming from the U.K.; the main pull now appeared to be from the continent.

In reply to another question by Mr. Shepardson, Mr. Coombs said he did not think much of the reflow could be attributed to the issuance of certificates of deposit in London by American banks. It was his understanding that the volume of such certificates outstanding was not large.

Mr. Daane asked whether much of the money being drawn in was likely to flow out again quickly if there was a change in international interest rate relationships. In other words, how "hot" were the funds being drawn in?

Mr. Coombs responded that the funds seemed to be fairly hot money. In a sense, the U.S. was buying protection in the short run, and there might have to be an accounting if circumstances changed. On balance, however, he thought it would be inadvisable to do anything at present to change those flows quickly. It was not possible to say where the money would go if it was not drawn to New York, and as long as the pull-back was not overdone the British should get by.

Mr. Brimmer remarked that he understood Mr. Solomon planned to comment on the subject in some detail in his remarks

later in the meeting. The pull-back of funds had domestic as well as international implications, and the Board had been giving the subject a good deal of consideration recently. The Committee might want to return to it after hearing Mr. Solomon's observations.

Chairman Martin suggested that the members might offer any comments they had on the subject in the course of the go-around.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System open market transactions in foreign currencies during the period September 13 through October 3, 1966, were approved, ratified, and confirmed.

Mr. Coombs noted that the original $450 million standby swap arrangement with the Bank of Italy--not including the $150 million increase negotiated recently--would mature October 20, 1966. He recommended renewal of the swap arrangement at this time for another twelve-month period. He would expect that in March, when the end of the term of the $150 million increase was reached, the two arrangements could be combined.

> Renewal of the $450 million swap arrangement with the Bank of Italy for a term of twelve months was approved.

Mr. Coombs noted that the $100 million standby swap with the Bank of France would mature on November 10, 1966. He recommended its renewal for another three-month period.

Renewal of the $100 million swap arrangement with the Bank of France for a term of three months was approved.

Mr. Coombs then noted that two three-month drawings by the Bank of England under its swap line with the System would reach maturity soon--a $100 million drawing maturing October 21, 1966, and a $50 million drawing maturing October 28, 1966. He recommended renewal of both for further periods of three months if the Bank of England so requested. That would be a first renewal for the $100 million drawing, and a second renewal for the $50 million drawing.

Renewal of the two drawings by the Bank of England was noted without objection.

Mr. Coombs noted that four three-month drawings by the System would be reaching maturity soon. They were two drawings on the Netherlands Bank, of $30 million and $25 million, maturing October 21 and November 7, 1966, respectively; a $25 million drawing on the Swiss National Bank maturing October 25, 1966; and a $25 million drawing on the Bank for International Settlements, also maturing October 25, 1966. He recommended renewal of the four drawings for further periods of three months, if necessary. All would be first renewals.

Renewal of the four drawings, as recommended by Mr. Coombs, was noted without objection.

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 September 13 through 28, 1966, and a supplemental report for September 29 through October 3, 1966. Copies of both reports have been placed in the files of the Committee.

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

> The money and bond markets have been subjected to wide swings in expectations since the Committee last met. At the moment the cloud of excessive gloom and pessimism that hung over the financial markets has for the time being lifted and a fairly confident atmosphere prevails--at least temporarily.
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> There are a number of factors that underlie this change in sentiment.
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> First, there is the growing market conviction that fiscal policy measures in addition to those announced on September 8 will be forthcoming in the near future to deal with the pressures on the economy--particularly the pressures stemming from the growing cost of the Vietnamese war. Rumors and the announcement of fiscal action had already had an impact on the bond market at the time of the last Committee meeting, but the additional discussion since that time has buoyed the market significantly further.
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> Second, international developments have generally tended to give the market heart. There has been a growing feeling that prospects for negotiation in Vietnam have improved. The lack of serious controversy at the annual meetings of the international monetary institutions, the feeling that the French seem to have isolated themselves, and the apparently better outlook for sterling have also been plus factors.
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> Third, despite continuing price pressures, the market has interpreted recent economic developments

as on balance indicative of some relaxation of pressure on the economy. And while heavy demands in the capital markets are still anticipated, there is not the same kind of rush to get on the financing schedule that was present in August, and the Administration's program of limiting the demands of Government agencies has reduced an important source of pressure in the markets. In this atmosphere, municipal and corporate underwriters have become more confident in performing their underwriting functions.

Finally, the financial markets--after uncertainty had neared a crescendo over the tax date--have become somewhat less apprehensive about the severity of Federal Reserve intentions with respect to monetary policy, although there is still a great deal of confusion about the proper interpretation of current discount window policy. The tax date was passed without the dire consequences that many had predicted. The CD runoff was large, but not as massive as had been feared, partly because a large amount of money became available as a result of a temporary investment of funds arising out of the financing of a corporate merger. As the Treasury rebuilt its tax and loan account balances, pressure on the money center banks relaxed somewhat and this contributed to a more comfortable tone in the money market. The relatively low net borrowed reserve figures published for the week ending September 21, the lower Federal funds rate prevailing throughout much of the period, and the prompt action by the System in conjunction with the FDIC and the Home Loan Bank Board on consumer CD rates, led to a feeling that the System might be paying more attention to the high short-term interest rates that had emerged. And this feeling was not entirely dispelled by the high net borrowed reserve figures published for the week ending September 28.

How long this atmosphere will last is, as usual, problematical. The underlying facts of the current economic and financial situation have not changed as much as expectations, and the markets have probably discounted developments that have yet to appear. Unless loan demand falls short of current expectations, there should be, as the blue book[1/] suggests, continued pressure on rates, particularly as the Treasury's actual

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

moves to raise the cash it needs before the year-end unfold. While the near-disorderly atmosphere that prevailed in the markets in late August and the heavy pressure on short-term rates that prevailed around the tax date may not be duplicated, the markets remain susceptible to new developments and to new expectations about the future course of monetary and fiscal policy.

Short-term interest rates reached new highs early in the period, with three- and six-month Treasury bills reaching records of 5.59 and 6.04 per cent, respectively, in the Treasury bill auction of September 19--a full 1/2 per cent above their end of August levels. In the changed atmosphere noted earlier, however, a strong demand for Treasury bills emerged with rates moving sharply downward again as dealers' positions were substantially reduced. By last Friday key rates were 10-20 basis points below their level at the time of the previous meeting. In yesterday's uneventful auction average issuing rates for the new three- and six-month bills were set at 5.41 and 5.67 per cent, respectively.

System open market operations both were conditioned by market developments and the shifting atmosphere that prevailed during the period and, to some extent, at least, influenced these developments. The week of September 21 was particularly complicated by a jittery Treasury bill market, tax date churning, and market fears of a still tougher monetary policy. In addition, country banks exhibited a tendency to build up their excess reserves more than normally during the first week of their statement period, thus immobilizing reserves that were available in the banking system. In order to avoid adding to the market's misapprehensiveness the System took only modest action to absorb reserves and net borrowed reserves were permitted to run at a low level. This approach to open market operations involved a risk that the market might conclude that the System had eased policy, but the logic of the approach was fortified by the behavior of the credit proxy, which at that time indicated that bank credit in September might decline at an average annual rate of about 4 per cent. In the following week, generally comfortable conditions prevailed in the money market as the previously built-up country bank excess reserves came into play, and the net borrowed reserve figure rose to its highest level during this period of

restraint. Hopefully, one result of the wide swing in net borrowed reserve figures--from $187 million to $568 million--will be to deemphasize their importance in the minds of market participants and analysts as a single indicator of monetary policy intentions.

It should be noted that required reserves and the credit proxy consistently fell below expectations during the period since the Committee last met. The credit proxy for September now appears to have risen only slightly after taking account of foreign branch balances at major U.S. banks, despite a new seasonal adjustment that tends to make the September figures look stronger than the old seasonal would. I believe we should continue to be cautious about overinterpreting short-run changes in the aggregates, particularly since it appears probable that seasonal adjustment patterns may be in a period of radical change. As the blue book indicates, the Board staff is now projecting a 5-6 per cent increase in the credit proxy over the month of October, with the pattern involving substantially higher growth by the end of the month compared with the end of September. New York Reserve Bank estimates involve a somewhat slower growth on average but about the same level at the end of the month.

Treasury financing operations will get underway again very shortly. An announcement of a cash offering of $3 to $3.5 billion tax anticipation bills is expected later this week, with the auction likely on October 13 and payment a week later. Toward the end of the month the Treasury will announce the terms of its November refunding, which probably will be utilized to raise some new money, with the possibility of a combined offering of short- and intermediate-term issues.

Mr. Wayne asked if Mr. Holmes would elaborate on his comment about a temporary investment in CD's resulting from a corporate merger.

Mr. Holmes said that about $1/2 billion had been invested in CD's in mid-September in connection with the merger of an oil and coal company. Roughly half of that sum had been borrowed from

banks and half from insurance companies. The CD's would mature in mid-October, and while the eventual disposition of the funds was uncertain presumably they would be spread around somewhere in the banking system.

Mr. Mitchell asked what Mr. Holmes expected with regard to October run-offs of CD's.

Mr. Holmes replied that from conversations with New York banks the picture seemed to be mixed. Some banks were optimistic about replacing a large percentage of their maturing certificates, particularly now that the level of bill rates had declined. Others expected losses of as much as one-half of their maturities.

Mr. Hayes remarked that despite the concern of some banks the general feeling seemed to be better now than it had been a month ago, and Mr. Holmes agreed.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period September 13 through October 3, 1966, were approved, ratified, and confirmed.

Chairman Martin then noted that legislation enacted since the preceding meeting of the Committee gave the System authority to engage in open market operations in securities that were direct obligations of U.S. agencies or were guaranteed by such agencies, and that a staff memorandum concerning such operations, dated

October 3, 1966, had been distributed. (A copy of the memorandum referred to has been placed in the Committee's files.) He thought some members of the Committee might be skeptical about the desirability of undertaking outright transactions in agency issues at this time. The Committee certainly would want to give careful consideration to that question, and also to the question of authorizing repurchase agreements against agency issues. The Chairman suggested that the Committee plan on considering the subject at its next meeting, after the members had had an opportunity to study the memorandum. No objections were raised to the Chairman's suggestion.

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. Partee made the following statement on economic conditions:

> Every once in a while almost any economist would give his eye teeth for just another couple of months' figures to help clarify what is going on. For me, this is such an occasion. Economic expansion has proceeded at a high rate through the summer and into the fall. Our preliminary estimates indicate a $14 billion rise in GNP for the third quarter, although about half of this appears due to higher prices, and the most probable outlook is for a similarly large rise in the fourth quarter of the year. At the same time, however, the performance of the stock market

and other attitudinal indices seems to evidence a deterioration in business and public sentiment. This, along with more fundamental indications of economic imbalance, raises growing questions about the prospects for continuing vigorous expansion, looking even a relatively few months further ahead.

One of the major questions in my mind concerns the behavior of inventories. Clearly there has been a substantial acceleration in the pace of accumulation, with monthly additions to manufacturers' stocks increasing from around $600 million in the early months of the year to more than $1 billion in both July and August. The latter represents an 18 per cent annual growth rate and contrasts with no gain recently in shipments, so that stock-sales ratios have increased abruptly.

It is hard to believe that manufacturers generally planned or desired this outcome, and in fact the expansion in inventories this year has consistently exceeded that indicated by Department of Commerce anticipations surveys. In order to keep to the year-end level projected by the latest survey, inventory accumulation would now have to drop to a 6 per cent annual rate. This seems exceedingly unlikely but, by the same token, a continued buildup well above desired rates sooner or later would lead to downward adjustments in output, with consequent implications for income payments and consumption.

The underlying strength of consumer demand is in its own right a question mark at present. Retail sales have rebounded well from their spring setback, which was mainly due to lower auto sales, but the early weeks of September were a bit weaker, due again to the auto market. There has not been time yet to test reception of the 1967 models, of course, so that September may be a poor indicator of prospects.

The latest University of Michigan survey reports that consumer plans to buy cars and home goods are fully as strong as a year ago. But that survey also shows a further decline in its composite index of consumer attitudes, reflecting mainly apprehension about rising prices, higher interest rates, and the possibility of a tax increase. In fact, the drop in the index this year has been just as sharp as it was preceding the 1957-58 recession. I don't have a great deal of confidence in the predictive value of such a measure. But to the extent that it may be significant one would

expect a tendency towards a higher rate of personal saving in coming months, rather than the slightly lower one embodied in present staff projections.

The rise in business capital spending, though it has been by far the strongest element in the private economy, may also have passed its point of inflection toward lower rates of gain. New orders for machinery and equipment have remained essentially unchanged for four months now and backlogs, though still climbing, have risen less rapidly since mid-year. The August Commerce-SEC survey also indicated a slowing in the rate of rise in plant and equipment outlays, from 17 per cent in the first half to 11 per cent in the second half of the year. And now the probable suspension of the investment tax credit may be having some further marginal effect on capital spending plans, as desired. In any event, one very recent private survey reports that business is planning little further increase in capital outlays for 1967 compared with 1966. Most capital budgets for 1967 probably are still quite tentative, but if the 3 per cent increase indicated were realized, there would almost certainly be a downward tilt in spending as next year progressed.

About near-term construction prospects there can be no doubt. Housing starts have dropped by about 500,000 units, annual rate, since early in the year, and the pattern of building permits--plus what we know of the mortgage market--suggests little or no improvement for at least the next several months. Residential construction outlays had declined by about one-eighth by the third quarter, and a further substantial decline is almost certain for the quarter now commencing. Private non-residential construction outlays also have declined significantly in recent months, and contract awards for commercial building have noticeably weakened. Presumably this also reflects mainly the mortgage situation, though overbuilding in some areas may be a factor.

Against this rather impressive list of weaknesses--present, probable and possible--must be weighed the rising trend in Government expenditures, particularly for defense. The figures on cash expenditures for defense in July and August suggest a further rise in

the third quarter of well over $3 billion and perhaps as much as $4 billion on a national income basis, but we have no specific information on near-term prospects other than the general indications of continued rapid growth reported at previous Committee meetings.

There are two considerations to be kept in mind regarding an expanding defense effort, however. The first is that this would not necessarily insure an expanding and ebullient economy; from mid-1951 through the next year or so there was little real growth in GNP and widespread evidence of weakness in the private sectors, despite (and in part because of) the Korean War effort. Second, spiraling defense costs would enhance the prospect that the Administration might seek a general tax increase, which of course could change the fiscal implications considerably. Such a development might well retard private sector demands enough to call for significant modifications in monetary policy.

Under present circumstances, whatever reasonable dampening of aggregate demand can be accomplished is all to the good. It is evident that there are still significant inflationary pressures on both the demand and supply sides of the economy, and that resource utilization remains very near capacity levels. At the same time, it would not seem desirable to ignore developments in the private sector that might lead to unnecessary slack and, with any easing in the defense effort, possibly to a cumulative downward movement later on. Given the uncertainties in the outlook, and recognizing the substantial degree of restraint on spending already achieved and still in process through monetary policy, I would not like to see any further tightening now. It may not yet be time to ease off appreciably, but the situation requires very careful watching and a willingness to do so whenever important weaknesses do in fact emerge.

Mr. Axilrod made the following statement concerning financial developments:

Credit markets during the past two months have moved from a period of severe strain to one during

recent weeks of comparative relaxation. In this movement expectations, demand forces, and supply conditions have all interacted.

As Mr. Holmes has pointed out, the decline in interest rates of recent weeks was influenced by growing market expectations that we are likely to have either a personal and corporate income tax increase or peace negotiations in Vietnam. Moreover, the emerging bits of news about economic prospects for the private sector of the economy did not seem to indicate quite as much basic economic strength as many had expected. And this impression was buttressed by the relative lack of strain in short-term markets after mid-September.

But unless expectational shifts are sustained by the fundamentals of demand and supply they are likely to be short-lived. Thus, the question becomes one of whether monetary policy has become tight enough so that it is causing cutbacks in real expenditures to noninflationary levels. Or whether credit demands are becoming less vigorous for other reasons, such as the investment boom's running out of steam on its own.

Monetary policy does appear to have become quite tight in recent months, even though we may disagree about what variables best symbolize this tightness. While net borrowed reserves have shown little change since June, money supply actually dipped slightly during the summer, interest rates rose markedly, and credit availability was significantly restrained at depositary institutions. And since the first of the year the money supply and total reserves have grown by only about 2.5 per cent, as compared with growth rates of around 5 per cent for both variables over all of last year.

With restrained growth in such monetary aggregates, interest rates have risen to the point where bank credit growth, too, has been held back, even though some funds are being obtained from abroad through the Euro-dollar market. Major lending banks are losing CD's, net, at a rate which we estimate at about between $1 and $1.5 billion per month in September and October. Moreover, the extent to which such losses can be made up by competing successfully against other savings institutions for consumer-type time deposits has probably been somewhat limited by the new structure of ceiling rates on time and savings accounts. And, perhaps more importantly, both banks and other savings

institutions remain hard pressed to compete with interest rates available on market instruments.

While the fund flows just described represent in large part shifts in the pattern of lending and not necessarily limitations on the total available for lending to final users of credit, this process of disintermediation does have its costs in terms of effects on the structure of interest rates. I would expect, for instance, that disintermediation would tend to raise long relative to short rates as banks and other financial institutions back away from long-term markets, while former holders of CD's are likely to purchase mainly short-term market instruments. Just as the movement toward bank intermediation that was set in motion by the Regulation Q changes in the early 1960's was a tonic for long-term markets, so is the reverse process of disintermediation likely to place a strain on such markets, especially in the transitional period when banks, nonbank institutions, and security markets are moving to a new equilibrium relationship.

But disintermediation may be more an effect than a cause in the current credit environment since, given current Regulation Q ceilings, it is basically monetary policy and credit demands that will determine the level of market interest rates, and hence the degree of disintermediation. Credit demands thus far this year have been buttressed by heavy corporate borrowing. This borrowing has been partly from banks, but has been especially heavy in the bond market as one might expect in a period when there have generally been expectations of rising interest rates.

By borrowing heavily earlier this year, corporations have apparently anticipated a part of their future need. One indication is that corporate liquid assets over the first three quarters of the year have risen by an estimated $2 billion (seasonally adjusted and excluding some special transactions), despite the acceleration in tax payments, as compared with no change last year over the same period. Thus, it appears that corporate capital market financing could be somewhat less heavy in the period ahead without necessarily indicating a reduction in real expenditures. However, if the moderation of the corporate calendar in recent weeks and the less than expected September expansion of bank loans to business continue for some time,

that would clearly tend to raise questions about the trend of the investment boom.

But while there may be some lingering doubt about the continued strength of business credit demands, it appears certain that Federal Government demands in the period ahead will be large--with perhaps $8-$9 billion of gross new borrowing probably required between now and year-end. Some abatement of business borrowing demands would be welcome in such circumstances; however, if business spending does continue high and they choose to dispose of their accumulated liquid assets instead of borrowing, renewed strains in the short-term market could develop as both business and Government attempt to utilize it as a source of funds.

With the supply of funds in the economy tight, with the future strength of private credit demands a bit uncertain, and with the duration of Federal Government demands also uncertain (because there may be a tax increase next year), this is probably a good time for monetary policy to hold roughly where it is for a while. But, in terms of day-to-day operations, the rein on money market conditions should probably be a fairly loose one. In this period of high uncertainty a flexible rein will enable the feedback of information from the nonfinancial world to have an influence on actual money market conditions. For instance, if money market conditions were showing a tendency to ease--as indicated by declines in the Treasury bill or Federal funds rates--this might suggest that credit demands were less than would be expected if economic expansion were continuing at its earlier pace. Accordingly, it would seem desirable not to fully offset such an easing tendency by exerting additional pressure on the net borrowed reserve position of banks.

On the other hand, in the somewhat more likely event that money market conditions tend to tighten up over the next four weeks in the face of the expected October increase in public and business credit demands, then at least some of this tautness might be captured even if it meant that net borrowed reserves moved deeper than they were during the past three weeks on average. But a significant movement toward deeper net borrowed reserves and tighter money market conditions should

probably be dependent on a greater than desired expansion in the monetary and reserve aggregates.

The restrained growth in bank reserves and the money supply thus far this year--and the absolute lack of growth in bank credit during the past two months--suggest to me that there is scope in the period ahead for added expansion in reserves, bank credit, and money. The blue book indicates the dimensions of a likely further expansion in October. Such an expansion in reserve and monetary aggregates would seem a useful means of helping the Government and the economy get over at least the first hurdles of the fall financing season, while the System awaits further clarification of basic economic and fiscal policy trends.

Mr. Solomon then presented the following statement on the balance of payments:

What I propose to do today is to review the impact on the U.S. balance of payments over the past year of the acceleration in total spending on the one hand and the tightening of credit conditions on the other--and to indicate some of the policy questions raised by these developments.

As best we can estimate it now, the deficit on a liquidity basis in the third quarter was at an annual rate of $2 billion. For the first nine months of the year, the deficit on the liquidity basis thus comes to an annual rate of $1.6 billion, only $200 million more than last year, despite the substantial deterioration in the trade balance.

On the official settlements basis, we appear to have had a surplus of about $1 billion in the third quarter, for rather special reasons to which I shall return later. In the first half of this year, the official settlement deficit was at an annual rate of less than $900 million, compared with $1.4 billion in 1965. All in all, the balance of payments accounts look better than might have been expected.

I turn now to a closer look at the major components of the balance of payments.

The most conspicuous effect of accelerated aggregate demand in the past year has been on U.S. imports, which

have increased much more rapidly than GNP. In July-August, imports were almost 25 per cent higher than a year ago. A surge of imports is a normal response to excess demand at home. What is encouraging is that exports have also continued to increase at a healthy rate. After some hesitation in the spring months, exports picked up again this summer and in July-August were 9 per cent larger than a year earlier.

Thus, most of the deterioration in the trade surplus can be attributed to the extraordinary increase in imports, which is in turn directly related to the excessive expansion of over-all spending in the U.S. economy.

It is reasonable to think that a slowdown in the expansion of aggregate demand will bring with it a slackening in imports. From the viewpoint of long-run balance of payments objectives, what is most important is that the price level not rise too much. A temporary bulge of imports accompanying a temporary surge of demand is less harmful to our competitive position than a sharp run-up in prices.

The other major factor contributing to a deterioration in the current account surplus over the past year is the increase in military spending abroad, which rose by $800 million (annual rate) from the first half of last year. Most of this increase was in Asian countries.

While the current account of our balance of payments has worsened substantially over the past year, the capital accounts have moved the other way.

The improvement on capital account shows up in four ways: (1) increased borrowing abroad by U.S. corporations to finance direct investment abroad; (2) net repayment of U.S. bank loans by foreigners; (3) borrowing of Euro-dollars by foreign branches of U.S. banks for the use of home offices; and (4) investment of liquid balances by foreign official and international institutions in U.S. assets that are classified as nonliquid.

Let me first dispose of this last item. The Committee knows that in the second quarter there was a shift of official dollar balances into CD's of more-than-one-year maturity and into agency issues. It is difficult to determine how much of this shift was a response to "jawboning" and how much to higher interest yields on these instruments. In any event, the liquidity deficit would have been about $400 million higher in the second quarter without these transactions.

Turning to other and less questionable capital flows, we may note the increase in borrowing abroad by U.S. corporations to finance direct investment. U.S. corporations issued nearly $500 million of securities abroad in the first half of this year, while foreign subsidiaries of U.S. corporations--so-called Luxembourg corporations--borrowed a similar amount. These borrowings abroad helped to reduce the outflow of dollars to finance what appears to be a strong determination of U.S. corporations to continue to expand their foreign operations. It seems reasonable to assign credit for the increased foreign borrowing to both the Commerce Department program and stringent credit conditions at home.

The Committee is well aware of the substantial contribution, on the plus side of the balance of payments, of net repayments of bank loans to foreigners. Over the first eight months of this year, net repayments amounted to more than $400 million, despite some renewed net lending in the second quarter.

Finally, we come to the inflow of short-term funds associated with the active bidding by foreign branches of American banks for Euro-dollars for the use of their home offices. This inflow is reflected in a large increase in "due to foreign branches" on the books of U.S. banks. It amounted to about $800 million in the first half of this year and a further $1-1/2 billion since the end of June. This massive absorption of dollars in foreign hands--or dollars that would have gone into foreign hands, including foreign official reserves--is the major explanation for the large difference between the liquidity balance and the official settlements balance thus far this year.

No doubt part of the improvement in the balance on official settlements this summer is a reflection of the speculative outflow of funds from the U.K. In effect, the dollars that the U.K. drew on the Federal Reserve swap line and from other sources and paid out in support of sterling were absorbed by U.S. branches abroad instead of flowing into official reserves in Europe. From the scanty data so far available, we know that increases in reserves of continental countries have been rather small this summer, and this is consistent with the recent strength of the dollar on foreign exchange markets.

> These massive short-term capital inflows are providing temporary relief to the balance of payments, which we cannot help but find refreshing. It is clear, however, that such short-term capital inflows do not represent a fundamental improvement in the balance of payments, and it is important not to be carried away by any pluses that appear in the accounts. One can go further and say that these inflows represent hot money that will flow out again as soon as pressure on bank reserves is relaxed. Thus we may hate ourselves in the morning in the sense that the relief we are enjoying at the moment may have to be paid for in one of two painful ways in the future: either a rapid build-up in European official dollar holdings requiring us to use the swaps, draw on the IMF, and sell gold, or a severe constraint on monetary policy when ease is called for.
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> We can take some consolation from the fact that when a move toward monetary ease becomes appropriate, excess demand will have subsided and imports will tend to slacken. Just as the extraordinary bulge of imports is being offset by extraordinary capital inflows, the later outflow of capital will be offset by a slowdown in imports.
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> Nevertheless, we must be prepared for the loss of these short-term funds, and, if we don't want monetary policy to be hamstrung in the future, we must be prepared to finance the outflow by drawing on the IMF and losing gold, unless we find ways to improve other components of the balance of payments in the meantime.

Mr. Hickman observed that one of the first uses of any hot money flowing out might well be by the British, in repaying their drawings on the System swap line, and to the extent that was so it would be a healthy development. Mr. Solomon agreed with Mr. Hickman's observation.

Chairman Martin said that preceding the go-around there might be brief reports on some of the developments at the recent

meetings of the International Monetary Fund and International Bank for Reconstruction and Development. He had attended a meeting of the Ministers and Governors of the Group of Ten on Sunday, September 25, which was chaired by Dr. Holtrop because the Finance Minister of the Netherlands was unable to be present. About two hours were spent in debating the wording of the communique that was subsequently issued. The communique reaffirmed the position the Group had taken at its meeting at The Hague in July. However, the French did not reassert the dissent they had made so vigorously at the earlier meeting, and there was some inclination to feel that that represented a slight softening of the French position.

The Chairman then invited Mr. Daane to comment on the meeting of the Deputies of the Group of Ten.

Mr. Daane said that the Deputies of the Group of Ten met on the afternoon of Friday, September 30. The meeting was largely procedural, and was concerned mainly with three questions: the arrangements and preparations for forthcoming joint meetings of the Deputies with the IMF directors, the arrangements and preparations for forthcoming meetings of the Deputies themselves, and the matter of electing a chairman of the Deputies. The first joint meeting probably would be held in Washington in late November or early December, although that fact was confidential at this point. The Deputies themselves would meet in Paris on November 16, 1966.

Dr. Emminger of the German Federal Bank had been persuaded to continue to serve as Chairman until sometime after the turn of the year.

Mr. Daane added that there was a definite spirit of forward motion in the meeting. The willingness evident to move ahead in concert with the directors of the Fund struck him as significant, particularly in light of the feelings on that question that some of the Deputies had displayed earlier.

Chairman Martin then asked Mr. Solomon to report on the meeting of Working Party 3 that had been held on September 23.

Mr. Solomon said that the recent Working Party 3 meeting focused mainly on the U.S. economy and the U.S. balance of payments. But in the course of the routine multilateral surveillance discussion--based on a presentation by Milton Gilbert of the BIS--some of the European representatives suggested that the Working Party should, before the end of the year, conduct a thorough discussion of the recent extension of the Federal Reserve swap network. Although the discussion was mainly procedural--the issue being whether or not such a discussion should be held at a future meeting--two points of substance were apparent: (1) did the extension of the swap network represent a "permanent or semi-permanent" increase in international liquidity and therefore did it have implications for the Group of Ten work on international

liquidity; and (2) was the United States planning to use the additional swap facilities to finance what was expected to be an enlarged deficit.

Mr. Solomon reported that Under Secretary of the Treasury Deming defended the swap extensions and insisted that discussion of them properly belonged among the central bank Governors at Basle. He (Mr. Deming) saw no reason for a discussion before the end of the year, since the renewal dates were spread out evenly over time. In any event, it was impractical to envisage that extensions would be talked about in WP-3 before they occurred. The matter ended inconclusively with a suggestion that those who had requested a discussion submit a note on what sort of discussion they had in mind.

As to the U.S. economy, Mr. Solomon continued, the U.S. delegation presented a fairly comprehensive review of monetary policy and its effects--both internal and external--over the past year. It was clear that the Working Party was strongly aware of the degree of monetary restraint that had been achieved and was not even hinting at additional monetary restraint. The two additional policy steps that were hinted at were, as might have been expected, further fiscal action and some further restrictions on direct investment.

Chairman Martin said he would make a further comment on the Bank-Fund meetings themselves, as he saw them. On the whole, they were much better than he had expected. The problem of the pound had been largely removed by the System's action in enlarging the swap network; the enlargement was viewed as postponing the problem, which was precisely what it was intended to do. There still was some concern about whether the U.S. was too complacent with respect to its balance of payments situation. The dialogue concerning new reserve assets had been advanced considerably; there was increasing awareness of the difficulty of designing a new asset that would supplement existing reserve assets without replacing them. He found that problem being discussed seriously by proponents of new reserve assets as well as by opponents. There was a disposition to think in terms of successive steps, with a first round involving an expansion of the existing activities of the IMF, and a new reserve asset coming into being subsequently rather than simultaneously. That approach made good sense to him, and while it was not exactly the approach now advocated by the U.S. it was worth consideration.

The one concern that overshadowed others at the meeting, the Chairman continued, related to the price of gold and to the role of gold over the next few years. It was recognized that if France continued to buy gold automatically the gold exchange

standard would be endangered. It was one thing for the French to buy gold because they questioned the manner in which the U.S. managed its affairs and accordingly were not willing to hold dollars; but it was another thing if they were buying gold simply for the purpose of embarrassing the gold exchange standard. It was generally recognized that in the absence of new discoveries gold production would be inadequate to meet world needs, and that there was a real problem with respect to speculation in gold. It was unfortunate that at the time of the meeting a British official implied that there might be an increase in the price of gold.

Mr. Wayne asked whether the Chairman would comment on the reactions to Secretary of the Treasury Fowler's hints that the U.S. might take drastic action to curtail capital outflows.

Chairman Martin replied that the reaction was generally adverse, as might have been expected. However, the Secretary's remarks might have served a useful purpose in impressing people with the seriousness of the situation.

Mr. Brimmer observed that on the subject of stronger U.S. controls of capital movements he had heard some favorable comment by Europeans who thought that the inflow of dollars to their countries was a source of inflation. They were hopeful that the U.S. would take steps in that area.

Mr. Galusha asked whether any pressure appeared to be building up behind proposed legislation to subsidize U.S. gold production.

Chairman Martin said there was some discussion of such legislation, but he did not think it was likely to be enacted in the present session of Congress.

Mr. Hayes observed that there had been a vigorous denial of the British official's remarks regarding an increase in the price of gold by the Chancellor of the Exchequer and the Governor of the Bank of England. They were disturbed and puzzled by those remarks, which were completely at variance with British policy. He (Mr. Hayes) was as pleased as Chairman Martin had been over the increasing realization that a new reserve asset, unless very carefully worked out, might constitute a threat to existing reserve assets and international liquidity. He had held that view for a long time. With respect to the developments at the WP-3 meeting reported by Mr. Solomon, it was clear from conversations he had had with several continental central bank governors that they had grave doubts about the wisdom of holding discussions of the swap network in the WP-3 meetings. They preferred to keep such discussions at Basle, and he also hoped that that would be the outcome.

In response to the Chairman's invitation to add his comments, Mr. Bopp said that the surprising thing to him was that no great

surprises came out of the Fund-Bank meetings. That perhaps was fortunate from the point of view of the U.S.

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

> The economic expansion remains very strong, and the outlook continues to be one of serious inflationary pressures well into 1967. In our Bank we hold to this opinion even though we recognize that some observers are beginning to take a less sanguine view of next year's business prospects. A change in Vietnam is always a possibility, but in the meantime the current and prospective defense build-up overshadows the moderation of some recent business indicators. According to our analysis, the fiscal stimulus by the Federal Government remains very substantial during the second half of calendar 1966 and will still be appreciable in the first half of 1967. While the President's restraint program has contributed a good deal to steadier financial markets and may have helped prevent a serious breakout of inflationary expectations generally, the actual fiscal measures announced so far can hardly be expected to have more than a minor direct impact on business and Government spending, and that not until some time in 1967.
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> We see little hope for a letup in cost and price pressures between now and mid-1967. In fact, cost-push pressures are becoming more serious, while the pressures of excess demand continue. Perhaps the absence of an inflation psychosis to date reflects in good measure the vigor and pervasiveness of credit policy, together with recognition that the Vietnam War is a major force behind the current boom and that its future impact on the Federal budget is too uncertain to make inflation a sure bet.
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> In analyzing the current inflationary threat and in considering possible means of combatting it, I think we should guard against the danger of placing too much of the blame on excessive expenditures on plant and equipment and excessive business lending. It seems to me that a too stimulative Federal budget is an even greater

contributory cause and that in any case the most desirable cure is not a sharp and deliberate reduction in private plant and equipment outlays. Because of the long-run contribution of such spending to increased productivity, I believe there should be at least equal emphasis on lower Government expenditures and an increase in personal income taxes, i.e., the use of fiscal policy to cut back consumption growth. Our recent efforts to slow the pace of business lending have seemed to me essential if an appropriate slowdown in total bank credit growth was to be achieved, but in my view we should avoid overemphasizing curtailment of business loan expansion for its own sake.

As for the balance of payments, the underlying deficit seems to be continuing at about the same rate as in the first half of the year, although the liquidity deficit will benefit again this quarter from special factors--in this case, debt prepayments. We doubt whether the August import decline is likely to persist. In general, the unsatisfactory trade surplus--with exports sluggish and imports at very high levels--continues to be the major adverse factor, along with the less measurable impact of the Vietnam situation. The various programs to reduce capital outflows seem to be working reasonably well, but this is perhaps more the result of the current domestic credit situation than the effectiveness of the programs themselves. In recent weeks the System has quite appropriately endeavored to learn more about the flow of funds to major U.S. banks from their foreign branches. However, I think we should have clearly in mind the beneficial effects of this flow--temporary though they may be--on the dollar in foreign exchange markets and in mitigating foreign central bank demand for gold. For these reasons, I would be very reluctant to see measures taken which would have the effect of reversing this flow, unless the domestic justification for such action was very strong indeed. If concern is felt about the failure of some of our credit series to reflect adequately these foreign fund inflows, the statistics can readily be adjusted to take them into account, as in fact is now being done both at the Board and at our Bank. Likewise the absence of reserve requirements for these liabilities does not mean that we cannot make due allowance in our policy determination for whatever contribution these foreign funds may be making to a greater degree of credit

expansion than would otherwise occur. Perhaps the best way of approaching this problem would be to make an informal suggestion to a few of the major banks involved not to press too hard on this source of funds.

As usual, the interpretation of recent data on bank credit is a perplexing task. Bank credit indicators of the last few months are heavily influenced by the increased amounts and changed pattern of corporate payments to the Treasury since April, for which statistical adjustments are difficult to make. Nevertheless, there is a good deal of evidence that the growth of bank credit in September was rather slow, following a relatively weak month of August. October may well see some pickup in this rate of expansion. Serious uncertainties both as to the probable amount of future CD runnoffs and as to the alternative methods by which banks may meet these drains also add to the difficulty of interpreting current and prospective credit data. As Governor Mitchell has pointed out from time to time, the change in degree of bank intermediation will suggest greater attention to total credit growth, but as a practical matter statistical measurement of total credit is impossible on a timely basis. Considerations such as these point up the difficulty of setting forth policy instructions in any very precise manner.

We shall soon be confronted with the need to maintain an even keel in view of the prospective Treasury cash borrowing in the near future. This in itself would suggest maintenance of an unchanged credit policy, but I believe such a policy is warranted in any case on general economic grounds. The securities markets have been notably unstable in recent weeks; and while the bond market is currently going through a phase of euphoria, this may turn out to be another instance of an excessive swing of the pendulum, to be followed by a swing in the other direction. Also, I think we must reckon with the fact that there are widely differing public interpretations and misinterpretations of the System's policy statement with respect to the discount window. In these circumstances, I think the Manager will need substantial leeway in order to cope with market developments, always in a context of maintaining a firm

but orderly money market. Both short-term rates and net borrowed reserve data should therefore be secondary considerations.

With respect to the discount rate, I feel that while we "missed the boat" in July, developments since that time have been such that I would not recommend action now. I have in mind, of course, the rapid escalation of market rates a few weeks ago, the joint efforts of the various regulatory agencies to moderate or even roll back deposit interest rates, and the fact that the Administration has at long last recognized the need for action in the area of fiscal policy. There may of course be new dramatic developments in the coming weeks pointing up the need for a prompt increase in the discount rate, but in the absence of such developments I would be reluctant to see such an overt rate action.

If I may digress for a moment on the subject of discount window administration, I should like to express the hope that the System would hold firmly to the line propounded in the September 1 statement in discussing with member banks a so-called new or revised discount program. It seems to me that the essence of the statement was that the window would be available as in the past to meet seasonal and unusual needs, in accordance with Regulation A; that the occasion of borrowing at the window would be used more aggressively than in the past to influence member banks in the direction of curtailing business loans in preference to other means of adjustment; and that if this route appeared feasible but also appeared to require a somewhat longer period during which the adjustment could be made, the System would be willing to acquiesce in such a delay. It is never easy to trace dollars in a large bank, and I am sure that there will be many instances of borrowing where it cannot be clearly stated whether a slowdown in business lending is the means for liquidation of the borrowing, even though this element may play an important part. What I feel concerned with and what I would like to see the System avoid is a concept on the part of the member banks that there are two clear-cut and distinct classes of borrowing at the discount window. The dangers of such a sharp distinction of borrowing "tranches" were discussed at length at the joint meeting of the

> Governors and Presidents on August 23, and it was noteworthy that the September 1 statement definitely avoided any such definite classification of borrowings. Doubtless an intra-System exchange of information with respect to borrowings of a longer than usual character may be quite useful, but I would hope that discount officers would not encourage the member banks themselves to look upon the Reserve Banks as administering two quite separate types of discount programs. Mr. Holland has prepared a draft letter to discount officers which I think deals very effectively with this issue.
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> It seems to me that the staff's draft directive1/ is quite appropriate.

Mr. Francis remarked that total demands for goods and services had continued to rise at a faster rate than productive capacity in recent months. As a result, the economy had suffered many inefficiencies due to the strain on its resources. The nation's trade balance was deteriorating, and prices were rising at an accelerated rate. Since May both wholesale and consumer prices had risen at over 4 per cent annual rates compared with about 3-1/2 per cent rates earlier in the year. The strong rise in total demand had been in part the result of very stimulative fiscal actions and the monetary expansion last winter and spring.

Monetary developments were more restrictive from June to September, Mr. Francis noted. Member bank reserves, which had been rising at a rapid rate, declined. The money supply of the country also reversed its strong upward trend, and commercial bank credit rose at a much slower rate. Most interest rates went up much more rapidly

1/ Appended to these minutes as Attachment A.

than in the preceding year. He would submit a table for the record showing this apparent shift of trend.1/

Mr. Francis commented that the fiscal influence of the Government had continued to be very expansive, reflecting both expenditures for Vietnam and the large outlays for welfare programs. The high employment budget, which indicated considerable fiscal stimulus in the year ending last June 30, was probably even more expansive in the second half of this year. In view of the strong demand for goods and services and the accompanying upward pressure on prices, the greater propensity to invest than to save, and the stimulative stance of the Federal Government, he felt that the increased monetary restraint from June to September had been appropriate.

Whenever there was a tightening in monetary actions, Mr. Francis continued, questions arose as to whether the monetary restraint was too restrictive and as to the length of time restraint should be exercised. In the current situation, the move toward restraint had apparently been substantial, but he believed it had not been too great. For one thing, current data frequently were misleading because of later revisions, problems of seasonals, and irregular movements. But even if it later appeared that monetary expansion had been halted, there were reasons to believe that there

1/ The table referred to is appended to these minutes as Attachment B.

might have been and continued to be a decline in the demand for money balances. The markedly higher interest rates which were now being experienced probably were causing some decline in the desire to hold cash balances. Also, with fiscal actions of the Government operating in such an expansionary way, the appropriate monetary growth was probably smaller than it might otherwise be.

Mr. Francis concluded that the June-September trends in monetary developments were appropriate and should be continued for the near future. If demands for credit were so strong in the next few weeks as to push interest rates up, the Committee should not interfere.

Mr. Patterson reported that, in the Sixth District, the effects of credit tightening were shown more clearly in financial data than in data measuring economic activity. Although the large city banks apparently expanded their business loans in September, after curtailing them in August, most business loans were made at substantially higher rates than those of three months earlier. At the large banks in Atlanta and New Orleans over 95 per cent of all business loans were made at rates of 6 per cent or higher during the first half of September, compared with 45 per cent in June. Generally firmer terms on business loans were reported with no diminution in the strength of loan demand. At the banks outside leading cities, however, loan expansion apparently was not large in September.

That the banks had been pressed for funds was suggested by the continued selling of U.S. Government securities and slowed-up purchases of municipals as well as a slower deposit growth, Mr. Patterson observed. Time and savings deposits remained unchanged at District banks in September with reserve city banks having had practically no change in their total time deposits for three months. Growth of demand deposits in September recovered part of the August decline but was less than would ordinarily have been expected at this time of the year. District banks had been net purchasers of Federal funds ever since late July.

Mr. Patterson noted that any analysis of economic conditions was complicated by the effects of the airline and construction industry strikes on the currently available statistics. Both total nonfarm employment and manufacturing employment were practically unchanged in August from the preceding month. District lumber and furniture industries suffered a decline, caused in part by receding housing activity. Announcements of new and expanded industrial plants in the third quarter continued in a large volume and probably totaled about $600 million, down only slightly from the $650 million total of the third quarter of last year. Proposed new and expanded pulp and paper activities made up a major part of the total. The textile industry seemed to be catching up with the demand for nonmilitary fabrics, although activity remained high.

On balance, the latest available financial and economic information suggested to Mr. Patterson a less frantic pace of expansion and a substantial bite on some sectors of the economy in the Sixth District. National data pointed to the same conclusion.

Mr. Patterson observed that for some time the System had laid stress on the growing demands for credit as being primarily responsible for tight money conditions. There had been backing for that statement in the continued expansion of the reserve base and the rapid rise in bank loans and total bank credit. That position was now less easy to support. Of course, the process of disintermediation, as Mr. Mitchell pointed out at the last meeting, might complicate the interpretation of bank credit data. However, it could at least be concluded that System policy had become a much more important factor in the recent credit tightening than it was a few months ago.

The coming Treasury financing suggested to Mr. Patterson that an "even keel" would be the appropriate policy to follow during the next period. However, aside from the even keel considerations, it seemed to him--as it did at the last meeting of the Committee--that policy should not be made more restrictive. The financial markets had behaved remarkably well recently considering the many strains they had undergone. The Committee should be very cautious about adding to those strains. He would, therefore, favor a policy of no change. The draft directive was acceptable to him.

Mr. Bopp commented that during the past few weeks there had been a virtual halt in expansion of total bank credit, a significant slowdown in the rate of increase in business loans, and a marked downturn in interest rates. On the basis of those developments, it might appear that the Committee was well on the way to achieving the best of all possible worlds: a significant bite into credit flows without a rapid escalation of interest rates. Yet the period ahead might well see a swift reversal in those trends. It was quite probable that interest rates would rise under burgeoning public and private demands for credit and that business loans would increase as tax, inventory, and capital spending pressures built up.

Certainly, Mr. Bopp continued, experience so far in the Third District suggested that banks were under pressure to expand business loans and that they would do all in their power to accommodate their favored customers. Indeed, one of the largest Philadelphia banks--recently coming under deposit strains--approached the Reserve Bank last week to discuss the conditions under which it might qualify for the special discount program. That bank had assumed that the principal *quid pro quo* expected was a holding of the line on total loans. When the bank found it would be expected to hold down business loans, it became more reluctant to borrow. That bank now was advertising heavily for 99 month consumer CD's at 5 per cent and had its loan officers on the phone soliciting new CD's and attempting to persuade existing CD

holders to renew their deposits so that it might avoid borrowing from the Reserve Bank. If other banks found it equally difficult to hold the line on business loans, it might be difficult to influence their behavior through administration of the discount window. It followed that significant upward pressures on business loans might be felt and that those pressures might be accompanied by rising interest rates as portfolio adjustments were made to permit loan expansion.

It might be, Mr. Bopp said, that the rise in rates itself would retard to some extent the loan increase and inhibit further portfolio shifts. The question remained, however, to what extent the System should exert a further restraining influence, thus intensifying the upward adjustments in rates and making it more difficult for the banks to hold CD's and adjust their portfolios in order to make business loans.

In Mr. Bopp's judgment the System's prime objective should be to maintain conditions favorable to the recent more moderate rates of growth in aggregate reserves and bank credit. If necessary to accomplish that objective, he would allow interest rates to firm, first in response to pressures from the market, and then--if needed--as a result of additional action by the System. However, he would not impose more restraint than needed to attain that aggregate goal in order to help implement the selective policy toward business loans. In view of the apparent reluctance of banks to borrow under the

special program, such a policy might lead to hyper-tightness, including a more rapid deceleration of total bank credit than was warranted by developong business conditions, and upward pressures on interest rates which could complicate Treasury financing and lead again to conditions of near-panic in financial markets.

Of course, Mr. Bopp concluded, policy over much of the next four weeks had to be directed toward an even keel. The imminent Treasury financing dictated that. In the meantime, the Committee would have a further chance to judge the strength of loan demand and to assess more fully bank response to the special discount program.

Mr. Hickman commented that this year there were more uncertainties and cross-currents than usual as the annual forcasting period was entered. Bulls and bears could make equally strong cases about the economic outlook, reflecting conflicting evaluations of strategic factors in aggregate demand. Despite the Administration's announced intent to make more use of fiscal policy, the analyst was faced with a step-up in defense spending, the magnitude and duration of which were unknown and perhaps indeterminate. Thus, any forecast of economic activity much beyond a quarter ahead could easily be wide of the mark and, as a consequence, could lead to inappropriate monetary policy, fiscal policy, or both.

With regard to recent monetary policy, Mr. Hickman believed that a great deal of pressure had been put on the banking system and

financial markets. Both the reserve base and the bank credit proxy declined on average in August and September, with influences to be felt later on, even though one might be unable to identify them or to quantify the time lags. Since labor productivity might decline if growth slackened, the Committee could over-play restraint and do more harm than good in its efforts to check built-in inflation, which would inevitably result from the failure to apply appropriate fiscal policy a year or so ago.

While recent money market conditions had been somewhat easier than he thought he was voting for at the last meeting, Mr. Hickman said, in retrospect he preferred what actually occurred to a further tightening. He recommended now that the Committee steer a course as near the middle of the road as feasible, while attempting to achieve money market conditions very slightly firmer than recently. The basic goal should continue to be to provide the reserves needed to achieve moderate expansion in money and credit, and to promote sustainable economic growth. The Committee should not seek to roll back the price level, or strain to hold it at present levels, since some inflation was now the inevitable result of past errors and omissions. He would vote for the proposed staff directive, which seemed to him to be reasonably near his position.

Mr. Hickman said he would like to devote a few minutes to summarizing the views expressed at the regular quarterly meeting of

Fourth District Business Economists held at the Cleveland Reserve Bank on September 20. The tone of the discussion was less bullish and more uncertain than in June. The median forecast of the group showed less than a 4 per cent increase in the production index for 1967, less than half this year's expected increase of more than 8 per cent. The median GNP forecast for 1967 was a gain of 6 per cent in current dollars, compared with about 8-1/2 per cent this year; in real terms, the group forecasted an increase in the range of 3 per cent to 3-1/2 per cent.

The group's forecast for corporate profits was not encouraging, Mr. Hickman continued. No one expected after-tax profits in 1967 to be more than 5 per cent greater than in 1966. Nearly half predicted a smaller gain, and the rest expected either no change or a decline in aggregate profits. Views on profits were based on the assumption that corporate income taxes would not be increased in 1967, although most of the group expected an increase.

There was widespread concern about the uncertain role of defense spending in the business outlook, Mr. Hickman noted. The group felt that capital spending would continue strong through midyear, with little or no short-run effects expected from the change in the tax credit and accelerated depreciation. Only one industry, paper and pulp, reported that capacity coming on stream was showing signs of becoming excessive. It was evident that the corporations represented were feeling the bite of monetary policy in varying degrees, although they

understood the System's problem and agreed with its objectives. The group was unanimous in recommending a better balance in the mix of monetary and fiscal policy.

Just before the meeting, Mr. Hickman observed, the Cleveland Reserve Bank had conducted a special survey on recent financial experience of the corporations represented. About half the respondents reported that they had borrowed external funds since June. Three-fifths of those borrowing had turned to commercial banks, one-third to the capital market, and the rest to parent companies or foreign banks. Only one corporation failed to obtain accommodation from commercial banks, and that company obtained the needed money in the capital market. Almost all borrowers reported paying higher interest, and individual companies reported a number of restrictive changes in credit terms. The results of the survey corroborated the view expressed by the Bank's directors at the last board meeting that the investment tax credit would have little short-run effects, but might do serious harm in a year or so when there might be need for a stimulus.

Mr. Brimmer said that he was concerned about the disposition of some people to have Working Party 3 engage in multilateral surveillance, as reported by Mr. Solomon. At the previous meeting of the Committee he had mentioned that he was disturbed by the tendency toward reviewing national economic policies in WP-3, but had been

reminded that that reflected a long-standing intent. Accordingly, he was pleased to hear Mr. Hayes say that some central bank Governors thought it was inappropriate to hold such discussions in WP-3 meetings.

With respect to the activities of U.S. banks in drawing in funds through their branches abroad, Mr. Brimmer concurred in Mr. Solomon's analysis, and he shared Mr. Hayes' and Mr. Coombs' views regarding the best approach to the matter. For the time being, anything the System did with regard to those flows might best be done quietly and informally. Nevertheless, he was disturbed by the flows. When the Board began to focus on the subject in August and asked the staff to develop background information regarding them, he had been convinced that the flows served to complicate monetary management. He was still of that view. He also was concerned about the question of equity. While it was true that the System could offset the inflows through use of its general monetary instruments, the handful of banks involved would be able to obtain additional resources and thus to opt out of monetary restraint, and the System's operations would shift the burden to other banks. Thus, while he agreed that no formal action should be taken at present he hoped that at a later time the System might consider steps to attain some control over those flows, through the instrument of reserve requirements or otherwise. Unfortunately, there now were rumors in the market about possible System actions in the matter. It could only be hoped that they would die down.

Turning to the balance of payments, Mr. Brimmer said some interesting developments were occurring outside the capital account. Some recent analyses by the Administration suggested that the low point in U.S. export performance might have been passed in the third quarter; if there was even a slight moderation in growth of imports, the trade balance might now begin to improve. Over the weekend he had participated in a bankers' forum sponsored by Georgetown University which was attended by some of the people attending the Bank-Fund meetings. Along with Mr. Roosa, and Mr. Shaw of the Commerce Department, he had taken part in a panel discussion on Saturday afternoon, in the course of which Mr. Roosa expressed the view that it was now time for the U.S. to take measures to reduce military spending abroad outside of Vietnam. Specifically, he urged that U.S. troop strength in Europe be reduced. Surprisingly, that proposal seemed to get a sympathetic reception. While there was a feeling on the part of some in the audience that the international situation might require maintaining present troop strength, there was a general disposition to consider the question favorably.

A second point of interest, Mr. Brimmer continued, was the view of some members of the group, expressed to him privately, that the U.S. might have to face up to more explicit controls over direct investment. During the panel discussion both he and Mr. Shaw had taken the position that, while there might be some logic to extending

the interest equalization tax to direct investments, such a step would be risky and was perhaps undesirable at this time. In personal discussions a number of the bankers present took exception to that position and indicated that the action might be desirable.

With respect to the domestic situation, Mr. Brimmer said he would not take issue with the analyses given today by the staff and the Committee members who had spoken thus far. He would hope, however, that the Committee would not again engage in "stop-and-go" operations in its effort to influence the rate of growth of bank credit. In one sense the sharp reactions in the market this summer reflected the difficulty the Committee had experienced in getting bank credit growth under control in the spring. If the Committee could avoid undue easing now it was less likely to be faced with a subsequent need to clamp down hard in order to restrain over-rapid growth of bank credit. He would accept the staff's draft directive with the hope that any deviations on the part of the Manager would be in the direction of slightly more rapid growth of bank reserves.

Mr. Maisel said it seemed evident that if it were not for a sharp projected increase in Vietnam expenditures over the next year the Committee would now be concerned that the level of demand might be about to shift to too low a level. Certainly many parts of the private economy now indicated a downturn in spending. At the same time, the individual costs of restricted monetary availability

appeared to be growing. On the assumption that the Government deficit would be covered by a tax increase, monetary policy should not add further to that pressure. Given the lags behind action, the Committee should attempt to see that reserves and credit expanded at a normal rate.

Mr. Maisel said he supported the draft directive, but would again make clear his belief that it should be interpreted as "no further firming," with the proviso meaning that conditions should be considerably easier if required reserves continued to come in under expectations and the credit proxy expansion fell below the 5 to 6 per cent annual rate expected for October.

Mr. Maisel thought the Committee should also recognize the base from which the present policy started--namely, average free reserves of minus $370 million; a three-month bill rate averaging under 5.10 per cent; and a Federal funds rate of close to 5.50 per cent. He thought the Committee should consider the sharp run-up in rates during the past period as unusual. He was not concerned with the fact that they occurred, since more randomness in movements should be welcomed and the market should be made aware of the fact that wider movements were to be expected. At the same time, however, the high rates should not be accepted as normal and as meeting the Committee's desires. The goal should be to return at least to the type of conditions prevailing before the recent run-up.

If high demand for loans did raise rates even with a normal increase in reserves and bank credit, Mr. Maisel observed, that should be allowed, but there should be no attempt to either raise rates or to hold them at present levels. If a normal expansion of reserves led to lower rates that should be accepted also.

Mr. Daane said that before turning to the subject of policy he would comment on two matters that had been touched on in the preceding discussion. On the question of multilateral surveillance, he would simply say that from the beginning that term had meant different things to different people. The issue Mr. Brimmer referred to was, of course, not a new one. From the outset the U.S. had taken the position that it was willing to furnish its statistics to the Bank for International Settlements--indeed, it had been more willing to do so than some other countries--and to have such information as seemed appropriate channeled through the BIS and the Governors meeting in Basle to Working Party 3. Multilateral surveillance at WP-3, as the U.S. delegation had seen it, and as Under Secretary of the Treasury Deming had reiterated, consisted of informal discussions of the economic and monetary developments and policies of the various countries concerned; questions of international credit assistance, swap lines, and so forth, were most properly discussed at Basle. From the outset he had shared Mr. Hayes' concern in the matter and had tried to help in avoiding formal surveillance procedures. But it was

necessary to recognize the desire of some of the Europeans to harden the procedures--to move to a more active review of countries' policies and to go beyond the stage of lecturing individual countries to something approaching a formal approval of international credit arrangements and financing policies.

That sentiment of the Europeans was perhaps most marked at the time the package of assistance to Italy was arranged, Mr. Daane continued. There was considerable resentment then on the part of the Europeans that the question of the Italian credit package had not been submitted to Working Party 3 for review. The U.S. view was that, if it had been submitted to WP-3, no stabilization package would have eventuated and Italy would not be in the position it was today.

On the question of the reflow of funds through foreign branches of U.S. banks, Mr. Daane said, he was not convinced that such reflows would necessarily complicate the implementation of monetary policy. He would concede that insufficient account might have been taken of them at times, but looking to the future, it was not inevitable that they would represent a serious constraint on monetary policy.

As to policy itself, Mr. Daane felt that at present it would be the course of wisdom for the System to stay "steady in the boat." Both the various existing uncertainties that had been mentioned and the prospective Treasury financings augured for maintaining an even keel. The draft directive appeared appropriate, except that it might be desirable to add a reference to the Treasury financings.

Mr. Mitchell said that he agreed with Mr. Partee's diagnosis of the economic situation; the private economy was showing unmistakable signs of some slippage. Recent inventory developments offered an impressive sign of weakness, even after allowing for the poor quality of the data and the uncertainty of the seasonal adjustments. The situation existing in the stock market for some time now did not augur well for future economic activity. The earlier general feeling of ebullience in the economy appeared to be completely gone. Various economic time series indicated that acceleration had ended, in some cases as much as a year ago. It was important to recognize that a great part of the economy--namely, the private sector--had not only lost much of its momentum but might be on the way down.

Mr. Mitchell felt that monetary policy had been playing a significant, and appropriate, role recently. However, he did not believe that in the U.S. economy today monetary policy could be used effectively to check cost-push inflation. The most that monetary policy could do was to slow down the rate of economic expansion. He also was impressed with the lagged effects of policy actions; some of the consequences of the Committee's actions earlier in the year were now appearing. And he was impressed with the fact that banks were now taking the kinds of measures to counter demands for business loans, as well as other demands, that the System had hoped for earlier--and they were doing so without coming to the discount window at all.

Accordingly, he believed the Committee now had all the restraint that was needed and, considering lags, perhaps more than was needed.

Mr. Mitchell said he would not want to see the System enter a period in which there was a real threat of a downturn without recognizing that threat. Part of the problem was that the Committee had, in a way, been hypnotized by the acceleration of defense spending. There was no doubt that defense spending had accelerated, but there also was no doubt in his mind that if the acceleration continued some further fiscal action would be taken. Thus, monetary policy would no longer be left to deal with the situation alone. All of that suggested to him that the Committee should be concerned that it did not go too far in the direction of restraint rather than not far enough.

Turning to the draft directive, Mr. Mitchell said that the only quarrel he had with the second paragraph was that he did not think the analysis underlying the staff's expectations for the credit proxy was very realistic, but he could not improve on it. He would suggest some changes in the first paragraph, however, to make the language more consistent with the staff views expressed orally today and in the green book.[1] Following the phrase at the end of the first sentence reading "despite the substantial weakening in residential

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

construction," he would insert a comma and add "uncertainties in equity markets, and a sharp increase in business inventories." In the phrase of the second sentence reading "credit demands remain strong," he would insert "still" before "remain." Finally, he would amend the statement of the Committee's policy in the last sentence of the paragraph by replacing the phrase "to resist inflationary pressures" with the phrase "to moderate the rate of growth in credit use."

Mr. Mitchell concluded by observing that he agreed with Mr. Hayes on the best manner at present for dealing with the pull-back of funds through foreign branches of U.S. banks. However, he thought there might well be some backlash in the future as a result of those inflows.

Mr. Hayes said he was not sure he understood Mr. Mitchell's suggested change in the last sentence of the directive's first paragraph. Was the term "credit use" meant as a synonym for credit expansion?

Mr. Mitchell replied affirmatively, but indicated that he had had total credit, rather than bank credit, in mind.

Mr. Shepardson agreed that there were some indications of lessening ebullience in economic activity. However, he felt that prospects for defense expenditures lent more strength to the economic outlook than Mr. Mitchell had suggested. All the evidence on defense

spending, limited as it was, pointed to significant further expansion, and the pressures that would involve had to be recognized. It was true that now, hopefully, there was greater prospect of fiscal action if those pressures developed; at the same time, such action was still in the future.

Given the conflicts among indicators and the uncertainties in the economic situation, Mr. Shepardson said, the staff's draft directive, as written, seemed entirely appropriate to him. He would interpret the draft as calling for essentially the degree of restraint that had existed in the recent period, with allowance for unexpected deviations of the bank credit proxy from the projections. At some point it might be appropriate to take a definite easing action but at this time, with the uncertainties existing in both directions, he thought it was desirable to maintain firm money market conditions. It would be unfortunate, in his judgment, if money market conditions were permitted to ease as a result of an easing in demands; by taking up any slack that might develop the Committee would maintain some measure of control until such time as it was able to develop a better assessment of the outlook.

Mr. Wayne commented that a feeling of uncertainty seemed to be more prevalent in the Fifth District even though employment remained strong and prices received and wages continued to inch upward. Rates of insured unemployment achieved, or remained near,

record lows. Textile industry respondents to the Richmond Reserve Bank's latest survey reported significant declines in new orders and backlogs and an increase in finished inventories. Reports had also been received that some textile mills had cut back to a five-day week. Major manufacturers of man-made textiles recently announced substantial price reductions for polyester blends, reportedly to bring quoted prices more nearly in line with the actual market and to counter the August reduction of cotton prices. Somewhat puzzling were reports that the Defense Department would reduce its purchases of military textiles this fiscal year perhaps by as much as 30 per cent--a move that might produce downward pressures on the prices of a number of products. Other manufacturers also reported sluggishness in the volume of new orders and some easing of backlogs. The strong demand that continued for boxing material and containers was an indication that shipments of finished goods would continue heavy. Without a clear indication of the reason for it, it was pertinent to note that building permits in the District were up substantially in August for the first time since last February--the principal weakness was in the northern part of the District. Thus far this season, flue-cured tobacco prices had averaged almost 7 per cent above year-earlier levels.

In the national economy, Mr. Wayne continued, activity remained high and spending continued strong. Industrial production

had moved ahead, although at a reduced rate, despite lower automobile production. Substantial gains in personal income supported a high level of retail sales. Employment also showed moderate gains but there were occasional reports that labor was not as scarce as it was earlier. The continuing pressure on prices was evidenced by public announcements of price increases in September covering over a hundred companies and a wide range of major commodities. Defense expenditures seemed to be running well ahead of estimates while education and welfare expenditures showed a steady and fairly rapid acceleration. Despite large increases in revenue from income taxes, the deficit in the cash budget for July and August was substantially larger than in the same months for other recent years.

Despite those sources of strength, however, inflation had not escalated in recent months, Mr. Wayne said. The rates at which prices and economic activity had been rising had not increased. In fact, there were indications to the contrary. Construction activity, of course, continued to decline. Manufacturers' new orders were down significantly in August. Weakness persisted in a few prices. Automobile sales remained low and there seemed to be some concern about the sales prospects for the new models. Scattered reports and speculations indicated uneasiness about the trend of corporate profits. Unit labor costs seemed to be inching up, interest costs were higher, and the suspension of the investment tax credit would gradually detract

from profits. If an increase in the income tax rate was added, the uneasiness could be converted into pessimism.

A somewhat longer look at developments confirmed the tendency toward slower rates of growth, Mr. Wayne observed. In the six months ending with August, nine major measures of economic activity, including wholesale and consumer prices, showed an average increase of 1.3 per cent for the period, which was substantially lower than the increase in any of the three previous half years. In the latest period, two of the measures registered declines; in the three previous periods there had been no declines.

As for policy, Mr. Wayne did not believe that the scattered signs of slower growth were sufficient to justify any easing at this time, although they might be adequate caution against further tightening. The slowing had probably been accomplished to a considerable extent by monetary restraint and if that pressure were relaxed, growth rates might bounce back, especially in the absence of further fiscal restraint. It was fortunate that the middle of September had been passed with relatively little trouble. The sharp drop in net borrowed reserves and the easier conditions in the money market which followed were perhaps a cheap price to pay for results attained. But he would not want to see the easier conditions restored. If the Committee gave the market reason to believe that policy had been eased significantly, it could lose much of what it had

worked hard to attain over recent months. It might be that the somewhat easier and more settled conditions in the money market during the last half of September were due to temporary factors and would shortly be reversed. It might be, however, that they were caused in part by actions of member banks to contain demand and to ration credit. If that should be the case, the Committee might be able to accomplish adequate restraint without quite such high interest rates or so much tension as there had been a month ago. Until it could be seen whether that was true, he would favor keeping a firm control on the availability of reserves.

Mr. Wayne favored adoption of the draft directive.

Mr. Clay remarked that while forthcoming economic developments could not be known with certainty, there appeared to be little reason to doubt that the national economy would continue under the pressure of over-stimulation, with resources tight and costs and prices rising. It might be that some sectors of economic activity would level off or decline, but the probable additions from the military sector suggested that aggregate demand for goods and services would remain in excess of the capacity for orderly production. Certainly, it appeared the better part of judgment that public policy, including monetary policy, should be formulated on that premise.

While proceeding on that premise led logically enough to the need for a policy of restraint, Mr. Clay continued, it did not indicate the particular monetary policy action to be taken at this time. Recent developments in both the commercial banks and the money and capital markets caused uncertainty on that point. Recent evidence did suggest that it would be appropriate to avoid added restraint on the commercial banks, but such short-run developments would not seem sufficient basis for a turnaround in policy. Perhaps the best course at this time would be a general goal of continuing the current monetary policy with a guide of "maintaining firm but orderly conditions in the money market." Higher interest rates would not be a target under such a policy, but rates would be permitted to rise if credit demands increased substantially.

The draft economic policy directive appeared satisfactory to Mr. Clay.

Mr. Scanlon reported that current discussions of economic prospects by Seventh District businessmen often included references to the sharp drop in housing starts, the reduced rate of auto sales, the continued decline in the stock market, further escalation in Vietnam, and "tight money." Nevertheless, no convincing evidence could be mustered in the District to indicate that demands were pressing less vigorously on the region's facilities and manpower.

Labor markets had tightened further, Mr. Scanlon said, and in recent weeks new claims for unemployment compensation had been

well below the reduced level of a year earlier. He had been unable to uncover any evidence that construction workers had been idled as a result of the decline in housing starts. Such workers apparently had been absorbed in nonresidential construction or in industry. Order backlogs of producers of machinery and equipment continued to rise in August, with defense orders helping to boost the total. He saw no evidence that orders had been reduced significantly as a result of the proposed suspension of the investment tax credit. A large Chicago area steel producer reported that demand from all major customer groups--including the auto industry--remained excellent, in contrast to some newspaper and trade journal accounts of a slower order trend.

Demands for credit by business still appeared strong, Mr. Scanlon observed. Expansion in business loans, after slowing markedly in August, continued at a moderate pace in September at major District banks, but whatever slackening had occurred seemed mainly a reflection of the restrictive loan policies of the banks. Responses to the September 15 lending practice survey indicated that most of the large District banks felt loan demand was stronger now than three months ago, and the majority expected that demand to show at least moderate increases in the fourth quarter. Most of the respondents stressed their lack of liquidity, uncertainty about their ability to replace CD money, and anticipated strong

loan demand as the major reasons for their firmer lending practices. Reserve positions of the Chicago banks were showing some additional pressure, with purchases of Federal funds up substantially and moderately greater use of the discount window.

With large prospective demands for credit both by Government and by private business through the fourth quarter, the pace of credit and monetary growth seemed likely to Mr. Scanlon to accelerate in the period ahead--again posing for policy a problem of maintaining adequate restraint within an acceptable range of interest rates. Recent data continued to show evidence of a general slowing in monetary and bank credit expansion since mid-year. It was apparent now that at least part of the recent increase in interest rates could be attributed to the cutback in the rate of growth in supply of loanable funds as a result of System actions. Given the current and prospective price and employment conditions, it appeared appropriate to undertake to maintain very slow rates of monetary and credit expansion. Therefore he favored a policy of maintaining the recent posture but with the proviso that the Committee undertake to offset the effects of any strengthened credit demand.

The draft directive was satisfactory to Mr. Scanlon, although he continued to have concern about the phrase "current expectations." It seemed to him that somewhere along the line the System might have to define that phrase, in retrospect. Whether

that meant reading into the record the contents of the blue book and, if so, whether the Committee's actions were consistent with those "current expectations" he was not certain, but it did cause him some concern.

Mr. Galusha reported that last week witnessed the establishment, in the Twin Cities area, of a new pattern of share and deposit rates. Area savings and loan associations, taking advantage of the recently announced Federal Home Loan Bank Board policy, introduced six-month savings certificates which paid the ceiling rate. Also, the one large savings bank in the Ninth District raised its rates on passbook and time deposits. And last Friday the largest bank in the District announced a 5 per cent small-denomination CD rate. Almost certainly, all the other reserve city banks in the District were going to follow, so it would seem that the implementation of the new rate-ceiling legislation had had the effect of raising rates. He need not tell the Committee, he supposed, that District bankers outside the Twin Cities were unhappy. Whether the savings and loan associations were going to fare better under the new rate structure than they did under the old was not something he as yet had any idea about. Also uncertain was the real impact a reflow in their direction might have on the depressed residential construction industry.

Mr. Galusha noted in passing that there had been very few member banks paying more than 5 per cent on time deposits, so dealing

with the distortions induced by a roll-back would not be a quantitatively significant problem.

Mr. Galusha said that large District banks seemed to have gotten through September fairly well and, whether rightly or wrongly, did not seem to be panicky about an October run-off of CD's. Borrowing from the Reserve Bank had been moderate and very much in the pattern of the past several months. The banks continued very reluctant to borrow under the new program of discount window administration.

Turning to the issue of policy, Mr. Galusha remarked that the GNP account projections contained in the green book seemed entirely reasonable to him. He certainly agreed that a highly probable increase in Federal defense purchases "dominates the economic outlook," but would add that, at the moment, relatively large increases in Federal civilian and State and local purchases also had to be expected. For a while to come, at any rate, State and local governments were going to be enjoying relatively high tax flows.

Accordingly, Mr. Galusha saw no strong case for forcing--or even permitting, in the face of temporarily reduced credit demands--generally lower interest rates. But neither could a strong case be made, it seemed to him, for forcing generally higher interest rates. Almost certainly the coming few months would witness

higher income tax rates--unless, of course, they witnessed a de-escalation in Vietnam, a possibility that only the most extravagant optimist could expect. Even if a tax rate increase were not in the offing, there would still be reason enough for waiting. It was not known as yet what the effect of suspending the tax credit and accelerated depreciation was going to be. Then, too, embarrassing as it might be to Committee and staff members, it was not known what effect current monetary stringency was having on the demand for plant and equipment. He sensed that it was appreciable; but he could not prove or even be highly confident about that. Like Mr. Mitchell, he, too, felt an uneasiness. In soundings taken with businessmen he sensed a common concern with the civilian side of the economy. But again, except for retail sales in the Twin Cities and residential construction, there were no clear signs visible to him. That was why he was an advocate of a cautious approach. And since the time until the new plant and equipment surveys would be available was short, waiting would seem to be prudent.

Mr. Galusha thus favored maintaining "firm but orderly conditions in the money market," and aiming not, perhaps, for last week's average of money market rates but for a slightly higher average. He would expect a slight firming of money market rates to be consistent with a rather considerable decrease in average

net borrowed reserves. But if events were to prove that expectation wrong, he would not back off from his rate objective. The market could easily be persuaded that a greater average net borrowed reserve figure did not mean the System had changed its mind about policy. The directive, as drafted, seemed fine to him.

Mr. Swan said that more complete figures confirmed the impression he had reported three weeks ago--that in the Twelfth District in August there had been no increase in nonagricultural employment and another small rise in the unemployment rate. August housing starts were above July but still well below the levels of each of the first six months of 1966. Perhaps some encouragement for the longer-run could be found in the fact that the rental vacancy rate was down in the second quarter from a year earlier. However, that rate remained higher in the west than in other areas of the country.

The most significant recent development in the banking sector, Mr. Swan continued, seemed to be the very small growth, both absolute and relative to the rest of the country, in business loans of District weekly reporting banks during the first three weeks of September. The increase had been only 1/3 of 1 per cent, compared with a rise of 2-1/4 per cent at weekly reporting banks outside the District. While the survey of lending practices in the District continued to show increases in the strength of business

loan demand, he wondered whether there were not some reporting lags in that area, as there were in others. Banks had tightened their business loan policies somewhat, but he would hesitate to ascribe the extraordinarily small increase in business loans solely to that factor.

On the other side of the balance sheet, Mr. Swan remarked, the major District banks had had their share of CD losses in the past three weeks--both corporate CD's and, more particularly, time deposits of States and political subdivisions. In the three weeks ending September 21, Twelfth District weekly reporting banks lost 5 per cent of their State and local government deposits, compared with a corresponding decline of 1/3 of 1 per cent outside the District; since mid-year the decline in the District had been 17-1/2 per cent, compared with 11 per cent elsewhere. Borrowings from the Reserve Bank were still quite low. Following the recent high reached in the week ending September 7, borrowings had declined each week both absolutely and relative to the rest of the country.

As the Committee knew, Mr. Swan said, the new ceiling rates on savings and loan passbook accounts were somewhat higher in California than elsewhere. The ceiling rates of 5-1/4 per cent on passbook accounts and 5 per cent on bank CD's under $100,000 were about in line with existing patterns. However, California associations could no longer offer 5-3/4 per cent on new bonus accounts,

in which there had been considerable growth during the past several months. As far as banks were concerned, a few smaller banks that had been offering 5-1/2 per cent on consumer-type certificates might suffer losses, but the great bulk of such deposits had been earning no more than 5 per cent. A number of banks had argued that the ceiling rate on CD's under $100,000 held by States and political subdivisions should have been left at 5-1/2 per cent rather than being reduced to 5 per cent. That was related in part to one kind of reaction that had occurred to the Board's earlier action with respect to multiple-maturity deposits; to some extent multiple-maturity deposits of governments had been replaced by a series of fixed maturity deposits, each of which was less than $100,000, and substantial losses of such deposits were now feared.

As to policy, Mr. Swan said, like Mr. Mitchell he shared Mr. Partee's concern about some of the recent developments in the private sector. Given the probable levels of defense expenditures, however, he saw no basis for an easing of policy, and he would continue about as at present for the next few weeks. While one might hope for additional fiscal action if defense expenditures continued to rise, such action was still in the future, and the Committee could not make any particular assumptions as to its form or intensity. Accordingly, it seemed to him that the Committee

should continue to maintain the policy of caution, with exceptions allowed for unforeseen developments under the proviso clause of the directive.

As to the wording of the directive, Mr. Swan would support the changes Mr. Mitchell proposed in the first two sentences. However, he would retain the phrase "to resist inflationary pressures" in the last sentence of the first paragraph, particularly in view of the statement earlier in the paragraph that inflationary pressures were persisting. But he was disturbed by the second part of the last sentence, reading "and to strengthen efforts to restore reasonable equilibrium in the country's balance of payments." Whose efforts were to be strengthened was not clear; one might infer that it was the Committee's efforts. But that would imply additional firming, which was not consistent with the rest of the directive. Perhaps the word "continue" should be substituted for "strengthen." With respect to the second paragraph, he agreed that some reference to the Treasury financings should be included, but it should be worded to avoid implying that the financings were the primary factor in the policy decision.

Mr. Irons reported that economic conditions in the Eleventh District had been strong recently, with inflationary overtones, but they were not surging. Nonagricultural employment had risen a bit, as it had for the past several months. The District industrial

production index continued at a high level and showed a year-to-year gain of 9 per cent. Construction activity varied from month to month, but for the year to date it was up about 10 per cent from the same period last year. Retail sales remained strong--thus far in 1966 they were 7 per cent above 1965--but new car registrations were relatively unchanged this year from last year. Agriculture was enjoying highly favorable conditions; moisture was good and the outlook was excellent. Cash farm receipts were up appreciably from the comparable period in 1965.

In the financial area, Mr. Irons continued, over the past three weeks loans at District weekly reporting banks were up about $90 million, with two-thirds of the rise occurring in commercial and industrial loans. Investment portfolios were reduced a bit, with most of the reduction in holdings of Treasury securities. Demand deposits in District banks were up substantially but time deposits were down a little, perhaps reflecting CD experience. Borrowings averaged $77 million as against $42 million in the preceding three weeks. Only one bank had evidenced any interest in the special program of discount administration, and apart from that bank borrowings in the District were relatively low. Average net purchases of Federal funds had been running a bit higher recently and there was a relatively wide use of the funds market, even among smaller country banks. There were indications, although slight as

yet, that some intermediate-size banks would shift from the Federal funds market to the discount window for liquidity purposes if the Reserve Bank would permit them to do so. Some banks had indicated that they interpreted the special program as involving a less tight administration of the window and they almost implied that if funds were to be made available more readily they would be interested in getting some of them.

Mr. Irons observed that the money and capital markets had been influenced by a variety of factors during most of September, including rumors as well as actual events, as had already been reported. The result was sharp and varying movements of rates and conditions in the market. He had been more satisfied with the conditions prevailing in the later part of the period than in the earlier part, but he noted that the markets had come through the difficult earlier time with much less of a problem than had been anticipated.

On the basis of observations in his District, Mr. Irons felt that bankers were now taking a somewhat different view than they had three or six months ago of the System's program for restraining bank loans. Earlier, the situation had been one of a scramble for funds to lend. Now, while the banks were not necessarily turning down every loan application they received, they

were clearly accepting the fact that it was necessary for them to carry out their part of the program.

As to policy for the coming period, Mr. Irons recommended maintaining firm but orderly conditions in the market. Inflationary pressures continued strong despite the fact that monetary policy was biting; he recognized the forces working in the other direction but still felt that the balance was on the inflationary side. Perhaps, however, the Committee should attempt at this point to achieve a little more stability in the market than had existed at times in the past month. The Treasury would be in the market, and their operations would have rate effects; and it was not possible to say what would happen in connection with the short-term CD's that would mature in October.

In sum, Mr. Irons favored continuing the policy of the past few weeks while trying to bring about more stable conditions and attitudes in the market generally. Any effort to ease policy would risk losing some of the recent gains, and any effort to firm would threaten to produce other undesirable conditions in the financial markets. The directive as drafted was acceptable to him; in particular, the second paragraph specified the proper objectives. Certainly, at this time the Account Manager had to have a great deal of flexibility to meet the situations that could arise from day to day--or even

from hour to hour, as had been clear during the recent period when he (Mr. Irons) had participated in the daily call. He would not favor any change in the discount rate at this time.

Mr. Ellis said that again he had to confess that the fundamental aspects of employment, production, and income in the First District fell into a more comprehensible pattern than did the financial counterparts of those activities. Measured in real terms, seasonally adjusted employment had continued rising in the latest available data. Factory output, paced by year-to-year gains of 20 per cent in machinery industries, had recorded a 13 per cent twelve-month gain. The Reserve Bank's fall survey of capital investment plans of New England manufacturers was nearly completed, and it indicated that 1966 outlays would exceed those of last year by more than one-third. Carry-over into next year of uncompleted programs would account for almost twice the normal 10 per cent recorded in previous surveys.

In the financial area, Mr. Ellis continued, like Mr. Hayes he found the data perplexing. In the past three weeks, business loans in New England leveled off on a plateau 17 per cent above last year's level. Other loans and investments continued to grow, however, as did both time and demand deposit totals. On balance, the large banks found themselves in a somewhat easier position than contemplated earlier. As a result, at least partially, borrowing

at the discount window in Boston declined by 35 per cent between August and September, at a time when borrowing in the nation rose by 4.7 per cent.

In good conscience, Mr. Ellis remarked, he had also to report that that regional variation in borrowing might trace to some differences in administration of the discount window. Following the September 1st letter, he had held face-to-face conferences with the District's eight largest banks, and he had discussed discounting in five area conferences including officers and directors of 41 per cent of member banks and 32 per cent of nonmember banks. Nowhere did he find any disposition to seek extended borrowing privileges as an assist in reserve adjustement during curtailment of business loans. But the Bank did receive queries reflecting the belief that Mr. Irons had mentioned, that discount administration had been eased.

Concerning the need that Mr. Hayes had noted for avoiding the concept of two discount windows, Mr. Ellis suggested abandoning the effort to tabulate statistics on the special discounting program. First, the intended use of the data was not clear to him, and he was not convinced that they would have any significant meaning. Secondly, the requirement that discount officers report on the program inevitably affected both the timing of their calls and

what they said when they talked with borrowing banks. Those aspects of the program could have undesired consequences.

Recently, Mr. Ellis said, a large life insurance company had advised the Reserve Bank that policy loan expansions in July and August each absorbed the equivalent of their present holdings of cash and short-term Governments. Their sales of stocks and bonds to meet that drain were quite painful in present markets. While they had a bank loan commitment of $25 million, they had not yet had to draw on it. They had requested an appointment with the Reserve Bank to discuss possible sources of liquidity if their pinch worsened. To date, he had learned of only one savings bank that was borrowing any significant amounts from commercial banks, and that was to forestall sale of near-maturity Governments.

On the national scene, Mr. Ellis continued, probably the most notable and salutary development had been the interruption of bank credit expansion in September. While it was tempting to conclude that monetary policy was now--at long last--biting enough to slow down the credit boom, he was disinclined to suggest any change in policy based on such a short-term development. He noted the projections for October indicated a resumption of credit expansion and run-up in reserves. The Committee should be careful to distinguish between inflection points, which it sought, and downturns into actual decline, which it did not seek.

Mr. Ellis viewed the Committee's principal problem today as one of usefully defining to the Manager a workable concept of "no overt change in policy." Unfortunately, the one week in which net borrowed reserves dropped below $200 million, in company with declining bill rates, did suggest to some bankers that policy was being eased. He agreed with Mr. Hayes that now was not the time to raise the discount rate. Unfortunately, however, the magnitude of the difference between the discount rate and rates on other reserve adjustment instruments threw into question the meaning of any given level of borrowing. In effect, the level of borrowing was a measure of how high and leakproof the System had built the dikes against borrowing by its discount administration.

Mr. Ellis commented that the staff projections of October growth rates in bank credit of 5.6 per cent, in required reserves of 9.9 per cent, and in the money supply of 7 per cent, were all premised on net borrowed reserves averaging $450 million, although such a level had not been attained in any month in the present period of tight money. Such rates of growth were clearly adequate if not excessive. Accordingly, he would conclude a net borrowed reserve target of $450 million was an entirely feasible starting point in setting policy objectives for October.

Mr. Ellis agreed with the staff comment in the blue book that "The outlook for the coming month is consistent with a tendency

not only for short-term markets to tighten but also for long-term rates to rise." However, he felt some inclination to challenge the usefulness of the subsequent and concluding paragraph, where it was suggested that "...a failure of (money market) rates to tend upward may mean that banks are under less loan pressure than we currently foresee..." Instead, he would anticipate that a failure of money market rates to rise would more likely result from the Committee's failure to re-establish the tightness experienced in August. He foresaw a danger, out of concern for Treasury financing, of repeating the December 1965 experience. By over-concern with the levels of rates the Committee could easily lose its grip on required reserves, and find them flowing out even more rapidly than the 9.9 per cent rate that the staff projected as likely if the Committee were to be successful in achieving a net borrowed reserve figure of $450 million.

As to the draft directive, Mr. Ellis said, the majority view expressed around the table was that it was appropriate, which he took to mean that it was vague enough to be acceptable. But he thought the Committee owed it to itself to determine what the language meant to it. The proviso clause began, "operations shall be modified in the light of unusual liquidity pressures..." He understood that to mean that operations should be modified toward ease in the event of severe liquidity pressures. The clause also

said that operations should be modified in light "of any apparently significant deviations of bank credit from current expectations." Underscoring the words "apparently" and "significant," he reflected that while the phrase was vague he understood it to mean that operations should be modified toward tightness if bank credit growth exceeded expectations. He agreed with Mr. Scanlon that the reference to expectations posed a problem. He thought the Committee should attempt to define its current expectations in the course of its deliberations; presumably the intention of the directive wording was to refer to the projections given on pages 4 and 5 in the blue book. He shared Mr. Swan's concern about the use of the word "strengthen" in the last sentence of the first paragraph and suggested use of the word "support."

Mr. Robertson then made the following statement:

> Everything I have read and heard in connection with this meeting seems to me to argue for a policy of very watchful waiting over the weeks ahead.
>
> On the one hand, the signs of slowdown in credit expansion and promise of more fiscal restraint make me disinclined to any further tightening of monetary policy just now. On the other hand, continued cost and price increases and the absence of any evidence of abatement in the strong upthrust of public and private spending make me wary of any shift toward monetary ease.
>
> While I do not want to be premature in the matter of easing, I most certainly do want us to be prepared to act promptly and at the right time. With as much cumulative restraint as we have built up within the System, and with all the lagged effects that will result from it in the quarters ahead, I think we have to be very much on our guard against staying too tight too long, but

we are just beginning to attain the goal we have been working toward and I am not yet convinced that the time for change has arrived.

The staff expects money market conditions to tighten a little as Treasury bill financing and corporate borrowing for tax purposes come into the picture in October. Consequently, a little firming would be appropriate if bank credit and particularly business credit run as strong as expected, or stronger. But if they turn out to be appreciably weaker, then I would want the Manager to begin to moderate reserve pressures somewhat, and not to have to wait for the next meeting to obtain a Committee authorization for doing so. Hence, the "proviso" clause in the directive can prove to be particularly helpful during the next few weeks.

The actions outlined are consistent with the substance of the directive as adopted at the last meeting, and I would favor adopting it again with the few language suggestions made by the staff; however, I would favor Governor Mitchell's suggested additions to the first two sentences of the directive.

Chairman Martin observed that the views on policy of Committee members appeared to be closer together today than they had been for some time. He would make just one observation. On the basis of reading he had done since returning to the office after his absence this summer, he was of the view that if it were not for defense spending the economy might well be experiencing a little downturn right now, and he did not think defense spending was a very strong prop for an economy. That led him to the view that monetary policy had done about all it should be expected to do at present. The proper course for Government policy at this juncture was clear; any substantial increase in defense expenditures

should be covered by a tax increase. He believed that that was recognized by the Administration, and if there was a supplemental budget request of any size it would be accompanied by a proposal for fiscal policy action.

The Chairman went on to say that the recent legislation relating to deposit interest rate ceilings had been handled as well as might have been expected. The legislation enacted probably was the least objectionable of the available means for solving the problems at which it was directed.

The present was a difficult period, Chairman Martin continued, with dislocations and disruptions in markets. Like Mr. Robertson, he was inclined toward a policy of "watchful waiting." He thought the Committee should seek to attain as much stability as possible, particularly in view of the prospective Treasury financings.

As to the directive, the Chairman suggested that the Committee accept the changes in the first two sentences of the staff's draft recommended by Mr. Mitchell, the substitution proposed by Mr. Swan of "continue" for "strengthen" in the last sentence of the first paragraph, and the inclusion of the reference to forthcoming Treasury financings in the second paragraph recommended by Mr. Daane. He did not favor Mr. Mitchell's suggestion that the first-paragraph phrase "to resist inflationary

pressures" be replaced by other language. Inflationary pressures were continuing, whether they were of the demand-pull or cost-push variety. He asked whether there were any objections to a directive formulated in the manner he had described.

Mr. Solomon commented that citing "a sharp increase in business inventories" among the signs of weakness, as Mr. Mitchell had suggested, might mislead readers of the policy record if they were not aware that a good part of the increase was involuntary. It might be better to say "despite slower growth in final demand than in output."

Mr. Mitchell said he would be willing to refer to an "involuntary" increase in inventories.

Chairman Martin commented that if the phrase was likely to be misleading it might be better to omit it.

Mr. Partee observed that of the two signs of weakness for which Mr. Mitchell had proposed adding references, he felt the inventory increase was more significant than the uncertainties in equity markets. He thought it would be understood from the context that much of the inventory rise was considered likely to have been involuntary and, in any case, the text of the policy record entry prepared for today's meeting undoubtedly would make that point clear.

There was general agreement with Mr. Partee's observations.

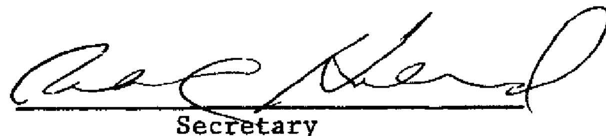
Thereupon, upon motion duly made and seconded, and by unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following current economic policy directive:

The economic and financial developments reviewed at this meeting indicate that over-all domestic economic activity is expanding vigorously, despite the substantial weakening in residential construction, uncertainties in equity markets, and a sharp increase in business inventories. Inflationary pressures are persisting and aggregate credit demands still remain strong. The balance of payments continues to show a sizable liquidity deficit. In this situation, and in light of the new fiscal program announced by the President, it is the Federal Open Market Committee's policy to resist inflationary pressures and to continue efforts to restore reasonable equilibrium in the country's balance of payments.

To implement this policy, and taking account of forthcoming Treasury financings, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining firm but orderly conditions in the money market; provided, however, that operations shall be modified in the light of unusual liquidity pressures or of any apparently significant deviations of bank credit from current expectations.

It was agreed that the next meeting of the Committee would be held on Tuesday, November 1, 1966, at 9:30 a.m.

Thereupon the meeting adjourned.



Secretary

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ATTACHMENT A

October 3, 1966

Draft of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on October 4, 1966

The economic and financial developments reviewed at this meeting indicate that over-all domestic economic activity is expanding vigorously, despite the substantial weakening in residential construction. Inflationary pressures are persisting and aggregate credit demands remain strong. The balance of payments continues to show a sizable liquidity deficit. In this situation, and in light of the new fiscal program announced by the President, it is the Federal Open Market Committee's policy to resist inflationary pressures and to strengthen efforts to restore reasonable equilibrium in the country's balance of payments.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining firm but orderly conditions in the money market; provided, however, that operations shall be modified in the light of unusual liquidity pressures or of any apparently significant deviations of bank credit from current expectations.

ATTACHMENT B

SELECTED MEASURES OF MONETARY DEVELOPMENTS
COMPOUNDED ANNUAL RATES OF CHANGE

	June 1965 to June 1966	June 1966 to September 1966[1/]
Money		
Money Supply	+ 5.8 %	- 1.4 %
Demand Deposit Component	+ 5.5	- 3.5
Currency Component	+ 6.9	+ 5.5
Time Deposits	+ 12.8	+ 8.6
Money Plus Time Deposits	+ 9.0	+ 3.2
Bank Reserves		
Total Reserves[2/]	+ 3.9	- 2.1
Reserves Available for Private Demand Deposits*	+ 3.8	- 3.8
Federal Reserve Holdings of U.S. Government Securities*[2/]	+ 7.2	+ 6.7
Interest Rates		
4-to 6-Month Commercial Paper	+ 25.8	+ 30.6
3-Month Treasury Bills	+ 18.4	+101.3
3-5 Year Governments	+ 22.5	+ 58.3
Long-Term Governments	+ 11.8	+ 13.6
Corporate Aaa Bonds	+ 13.7	+ 37.5
Municipal Aaa Bonds	+ 14.3	+ 39.2
25-Year FHA Mortgages	+ 19.9	+ 15.7[a]
FHLB Average of Conventional First Mortgage Loans Including Fees and Charges	+ 6.2	+ 22.7[a]

1/ September figures are estimates.
2/ Adjusted to include effects of changes in reserve requirements on time deposits.
a June to August, partially estimated.
* Seasonally adjusted by this Bank.

Prepared by Federal Reserve Bank
of St. Louis
October 3, 1966