MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, January 9, 1968, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman[1]
Mr. Hayes, Vice Chairman
Mr. Brimmer
Mr. Daane[1]
Mr. Francis
Mr. Maisel
Mr. Mitchell
Mr. Robertson[1]
Mr. Scanlon
Mr. Sherrill
Mr. Swan
Mr. Wayne

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

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

Mr. Holland, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Molony, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Brill, Economist
Messrs. Baughman, Craven, Hersey, Partee, and R. Solomon,[2] Associate Economists
Mr. Holmes, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Fauver, Assistant to the Board
Mr. F. Solomon, Director, Division of Examinations, Board of Governors[2]

[1] Entered the meeting at the point indicated.
[2] Withdrew from the meeting at the point indicated.

Messrs. Axilrod and Williams, Advisers, Division of Research and Statistics, Board of Governors
Mr. Reynolds, Associate Director, Division of International Finance, Board of Governors
Miss Eaton, General Assistant, Office of the Secretary, Board of Governors
Miss McWhirter, Analyst, Office of the Secretary, Board of Governors

Messrs. Heflin and Strothman, First Vice Presidents of the Federal Reserve Banks of Richmond and Minneapolis, respectively
Messrs. Eisenmenger, Link, Eastburn, Mann, Brandt, Andersen, and Tow, Vice Presidents of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Atlanta, St. Louis, and Kansas City, respectively
Messrs. Geng and Snellings, Assistant Vice Presidents of the Federal Reserve Banks of New York and Richmond, respectively
Mr. Kareken, Consultant, Federal Reserve Bank of Minneapolis

Noting that Chairman Martin had been unavoidably detained, Mr. Hayes, Vice Chairman, called the meeting to order.

By unanimous vote, the minutes of actions taken at the meetings of the Federal Open Market Committee held on November 27 and December 12, 1967, were approved.

The memoranda of discussion for the meetings of the Federal Open Market Committee held on November 27 and December 12, 1967, were accepted.

By unanimous vote, the action taken by members of the Federal Open Market Committee on December 14, 1967, increasing the swap arrangement with the Bank for International Settlements providing for System drawings in Swiss francs, and the arrangement with the Swiss National Bank, each from $250 million to $400 million equivalent, effective immediately, and approving the corresponding changes in paragraph 2 of the authorization for System foreign currency operations, was ratified.

The reports of audit of the System Open Market Account and of foreign currency transactions, made by the Board's Division of Examinations as at the close of business September 22, 1967, submitted by the Chief Federal Reserve Examiner under date of October 31, 1967, and distributed to the Committee under date of December 8, 1967, were accepted.[1]

Mr. Frederic Solomon withdrew from the meeting at this point.

Mr. Hayes noted that Mr. Robert Solomon had been a member of the mission headed by Under Secretary of State for Political Affairs Rostow that had recently traveled to the Far East to help explain the new U.S. balance of payments program to officials of Japan, Australia, and New Zealand. He invited Mr. Solomon to comment on the discussions.

Mr. Solomon remarked that, as the Committee knew, the Asian mission in which he had participated had been one of two similar missions; the other, headed by Under Secretary of State Katzenbach and Under Secretary of the Treasury Deming, had traveled to Europe. Between them, the two missions visited the major trading partners of the United States to explain the nature, general philosophy, and

[1] Copies of the audit reports have been placed in the files of the Committee.

purpose of the new program as well as the role of U.S. domestic economic policy in meeting the balance of payments problem; to solicit their cooperation; and to hear their reactions. He could not report from first-hand experience on the discussions in Europe, but since the main aim of the program was to reduce imbalances in U.S. international transactions with the countries there, the discussions presumably differed in some respects from those in which he had participated.

Mr. Solomon went on to say that officials in all three of the countries his mission had visited displayed a fine spirit of cooperation and an acceptance of the need for the program. For example, the Japanese Finance Minister had said that "defense of the dollar is defense of the yen," and had indicated that his country was pleased to see the dollar defended. But after expressing such sentiments the officials of each of the three countries expressed specific concerns about the effects of the program on their own balance of payments.

The Japanese were most worried about the possibility that the United States would institute a border tax adjustment, Mr. Solomon observed. Apparently the statements on that subject in the President's message were not wholly clear to them. The message included some observations to the effect that U.S. commerce was put at a disadvantage by the practice in some countries of giving tax rebates on exports and imposing special border taxes on imports, and that consultations looking toward removal of that disadvantage were being undertaken, particularly with surplus countries. Those observations were followed by a brief statement about legislation in preparation "whose scope and nature will depend on the outcome of these consultations." The Japanese expressed deep concern about the possibility that the United States would introduce a similar border tax and tax rebate system if the Europeans did not make some sort of adjustment in that area. They were concerned not only about the direct effects such an action would have on their trade with the United States but also about the possibility that it might result in reprisals and a general escalation of trade barriers between European countries and the United States. They did not express much concern about the Federal Reserve program; indeed, they thought the fact that the program called for greater net repayments of U.S. bank loans to continental Europe than the over-all reduction sought would leave room for them to increase their borrowings from U.S. banks somewhat in 1968.

Australia, of course, is much more heavily dependent on direct investment from the U.S. than is Japan, Mr. Solomon continued. After indicating that they welcomed the program, the Australians expressed great concern about its implications for the rate of their internal development and for their balance of payments.

They stated that U.S. transactions with their country did not contribute to the U.S. balance of payments deficit, and they reminded the members of the mission of their willingness to cooperate with the United States with respect to Vietnam and other matters. They asked for a commitment from the United States that Australia's reserves would not be reduced below some level, presumably the present level.

Officials in New Zealand expressed concern about reductions in U.S. direct investment and in tourism, Mr. Solomon remarked. Like the Australians, they said that transactions with their country did not contribute to the U.S. balance of payments deficit and asked whether it was reasonable for the United States to attempt to cure its balance of payments problem partly at their expense.

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 December 12, 1967, through January 3, 1968, and a supplemental report covering the period January 4 through 8, 1968. Copies of these reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Coombs said that the Treasury gold stock would remain unchanged this week.

About $80 million was on hand in the Stabilization Fund which, of course, would not last long if another wave of speculative buying occurred. But, fortunately, the situation in the gold market had turned favorable since the announcement of the new U.S. balance of payments program; the price of gold in London had declined from $35.20 to a level today of about $35.13, and the pool had taken in about $9 million since the first of the year. In the absence of serious new disturbances, during the next few months the pool might recover several hundred million dollars of the abnormally heavy gold losses sustained in November and December. The experience in the past had been that only a small fraction of gold sold on the London market was later returned to the market, but there might be some reflow now from Swiss industrial firms that had bought sizable amounts in the past two months. Prospects were much more uncertain for the subsequent period, when developments would depend on whether or not the basic disequilibrium in the gold market would reassert itself. The scare story put out by the French newspaper Le Monde last Friday, to the effect that new restraints on the gold market were being considered, was quickly denied and had no effect on the market.

In the exchange markets, Mr. Coombs continued, the dollar had strengthened against all of the continental European currencies and sterling had also shown some minor improvement. In part those developments were seasonal; both the dollar and the pound normally strengthened at this time of year. But he thought that to an important extent they also reflected a recovery in confidence generated by the new U.S. balance of payments program.

Unfortunately, Mr. Coombs remarked, the new sterling parity was still not being fully accepted as tenable. As the Committee members might know, the British lost another $300 million in December, quite aside from year-end debt payments. Devaluation had given them the opportunity of improving their trade balance considerably in 1968, but they had simultaneously incurred new heavy burdens. Those burdens included prospective profit-taking on forward commitments assumed by the Bank of England during the past three years, which might involve a total cost in 1968 on the order of $500-$700 million; a progressive liquidation of sterling area balances, which had amounted to $375 million since devaluation and was likely to continue; and now the effect of the U.S. restraints on capital outflows and tourist spending. The new burdens might add up to well over $1 billion in 1968. At the Basle meeting this past weekend the British officials spoke in terms of "making some progress" on their balance of payments in 1968 and "having to wait until 1969" for restoration of equilibrium. Meanwhile, the British Government was working out a program of cuts in Government and other expenditures to be announced before the end of the month. The total cut sought was about £1 billion, but it was rather doubtful that it would take effect within one year; more likely, it would be stretched out over several years. If those measures were not persuasive, there could be further serious trouble. There was a good deal of talk in the market to the effect that if sterling's difficulties were not overcome the British might move to a floating exchange rate.

There was no further discussion of gold at the weekend Basle meeting, Mr. Coombs continued. The governors were prepared to wait to see how the new U.S. program worked out, and they did not press for immediate contingency planning with respect to the gold market, as they had at the December meeting. Much of the discussion was concerned with the sterling balance credit package, first negotiated in June 1966, which would reach another maturity in March of this year. The matter was considered at the technical level at this meeting and would be subject to a more fundamental review at the February meeting.

Mr. Coombs believed that most of the European countries would be inclined to renew the sterling balance arrangement for another year rather than insisting that the British draw on their $1.4 billion standby facility with the International Monetary Fund to settle the $1 billion in debt now outstanding under the arrangement. He thought that would be helpful since the British obviously needed time to get a grip on the situation. Renewal would involve no particular problem for the United States since the U.S. share in the agreement was almost fully covered by Treasury and Federal Reserve holdings of guaranteed sterling which, as the Committee knew, carried no fixed maturity date.

On the other hand, Mr. Coombs observed, there was much talk in European circles of the need to do something about the overhang of the sterling balances. They represented a source of continual attrition of British reserves, and the Europeans felt that sterling holders in the Middle East and elsewhere would be collecting on their balances out of funds provided by new credits to the British from European countries and the United States. No one seemed to have a clear idea of how to approach the problem, which obviously was a dangerous one. With the emergence of the French as a hostile element any form of contingency planning would involve a serious risk of leaks. For example, it might be suggested by some European central banks that sterling area countries accept some sort of freeze on their sterling balances; if that suggestion were made, any leak would accelerate the drain. It was clear that a good deal of careful thought had to be given to the problem.

The second major subject of discussion at the BIS meeting was the prospective effect of the new U.S. measures, Mr. Coombs said. The program was generally greeted with relief and great satisfaction, although in individual cases concern was expressed over the impact of the investment and tourist cuts. Thus, the Belgians were worried about a reduction in U.S. investment in their country. That position was not an inconsistent one for them, since they had welcomed American investment over the years and at present were concerned about the need for relief in areas depressed by the closing of coal mines. Also, the Italians and Swiss were mildly worried about the cuts in tourism.

However, Mr. Coombs observed, by and large the participants welcomed the program and expressed their willingness to cooperate. In appraising the likely consequences, most attention was given to the risk that the U.S. measures might have a depressing effect on the continental European economies, and might handicap the recovery now beginning in Germany and elsewhere. Mr. Blessing of the German Federal Bank argued strongly that European governments and central banks must continue to stimulate expansion and accept any reserve losses as healthy consequences of a U.S. return to equilibrium, and there was general agreement with Mr. Blessing's approach. Also, various suggestions were made that the European central banks should coordinate their monetary policies more closely and that any central bank which felt compelled to tighten its credit policy should give advance notice to the others. That was an important development; heretofore there had been relatively little consultation among the Europeans with respect to their internal policies.

A number of views were expressed about the prospective impact of new heavy borrowing requirements by U.S. firms on both the Euro-dollar and local European financial markets, Mr. Coombs observed. In general, with the exception of the French, the central bank governors seemed inclined to encourage the provision of fully adequate short-term credit facilities to established U.S. industrial firms, but to take a fairly restrictive line on new enterprises, particularly if they involved a takeover of European firms. In the past the Europeans had not protested very much about growth of established U.S. firms in their countries. The main complaints had concerned the takeover by U.S. companies of existing European firms, particularly when the price seemed to be out of line.

On the nature of European credit policies, Mr. Coombs continued, Governor Carli of the Bank of Italy indicated that his Bank intended to intervene in both the long- and short-term markets in order to keep rates as stable as possible. Governor Carli urged his European associates to follow similar policies and, more generally, to avoid a contraction of money and credit as reserves flowed out, by substituting domestic for foreign assets as backing for the money supply. That might prove to be a troublesome point in Switzerland, the Netherlands, and Belgium, where the central banks had traditionally allowed the money market to tighten as funds flowed abroad. By and large the central banks of those three countries over the past several years had operated almost as currency boards. While to some extent that practice simply reflected tradition, in part it was due to institutional deficiencies in their local money markets. He thought that was an area that should be watched closely, since any success the U.S. had in improving its balance of payments could be nullified in part by pull-backs of funds to such countries.

In conclusion, Mr. Coombs said much concern was expressed at the Basle meeting lest the prospective strain on European credit markets should be aggravated by a severe tightening of credit in the U.S. He had been urged to transmit to the Committee two points on which considerable emphasis was placed. The first, and foremost, was that a competitive escalation of interest rates might easily develop in the absence of a tax increase and expenditure cuts in the United States. Secondly, attention was drawn by a number of the governors to the pressures on the Euro-dollar market resulting from the borrowings of U.S. banks. Those borrowings had been considered reasonably tolerable up to this point. However, it was thought that if they continued--and particularly if they intensified--they would complicate the problem of implementing orderly and compatible policies with respect to interest rates and money market conditions in Europe and the United States.

Mr. Robert Solomon left the meeting in the course of Mr. Coombs' remarks.

Mr. Hickman referred to Mr. Coombs' final comment and asked whether the European central bank governors had made any specific recommendations as to appropriate U.S. policy if U.S. bank borrowings continued to put pressure on the Euro-dollar market.

Mr. Coombs replied that the only specific comment in that connection was a reference by Mr. Stopper of the Swiss National Bank to the fact that U.S. reserve requirements provided an incentive to American banks to borrow in the Euro-dollar market. No reference was made to Regulation Q. There was a natural tendency on the part of the governors at Basle to avoid specific suggestions as to U.S. domestic policies since that might be considered as undue interference in American affairs. But they did feel that continued pressure on the Euro-dollar market from U.S. bank borrowings would handicap their efforts to maintain stable conditions in their own markets. That was an understandable concern. As the Committee knew, he (Mr. Coombs) personally had been concerned that borrowings by U.S. banks in the Euro-dollar market would impede the British effort to restore their balance of payments position, and he thought that such borrowings might have been a contributing factor in the devaluation of sterling. One difficulty at the moment was that no one had any clear view of the magnitude of the requirements of U.S. firms for financing in Europe.

In reply to a question by Mr. Hickman, Mr. Coombs said that U.S. firms presumably would be borrowing in both local currencies and Euro-dollars. Immediately after the announcement of the U.S. program all major U.S. firms in Germany sought lines of credit with the larger German banks. However, he was sure they were also counting on meeting a great part of their financing needs in the short-term Euro-dollar market and in the Euro-bond market.

Mr. Hayes remarked that the question of restraining U.S. bank borrowing in the Euro-dollar market was complicated by the fact that, unless such restraint was offset by domestic open market operations, it could contribute to tightening in the U.S. money market.

Mr. Brimmer noted that in the course of one of the System's daily conference calls on foreign exchange market conditions a member of the staff at the New York Bank had suggested that the System might support a program of sales of dollars into the Euro-dollar market to moderate any tendency for rates to rise there. He (Mr. Brimmer) would not favor a policy under which operations were automatically undertaken to moderate Euro-dollar rate pressures. At a minimum, the situation should be examined more closely while conditions were allowed to settle down somewhat.

Mr. Coombs said he agreed completely with Mr. Brimmer's observation. The rationale underlying past operations in which the BIS had drawn on its swap line with the System to intervene in the Euro-dollar market was that such intervention should be directed at moderating pressures that arose abruptly--such as those resulting from the Middle East war last June--and in any case it should be carried out for only a limited time. It would be a mistake, in his judgment, to deviate from that approach. He had not been aware of the suggestion to which Mr. Brimmer had referred, and did not agree with it.

Mr. Hayes said he also had been unaware of the suggestion and disagreed with it.

Mr. Brimmer then referred to Mr. Coombs' comment regarding the requests by U.S. companies for credit lines at German banks and noted that it was his impression that such requests were primarily for expansion of existing lines. On that basis he thought they were reasonable and that one might expect them to be accommodated.

Mr. Coombs said he thought the Germans probably would do their best to accommodate such requests, which in general seemed to represent an effort by U.S. firms to line up credit sources for possible future use.

Mr. Mitchell asked whether the central banks of Germany and Italy might be expected to supply funds to the Euro-dollar market. Such a course would seem consistent with the views of Messrs. Blessing and Carli that Mr. Coombs had cited.

Mr. Coombs replied the Italians had already supplied a large volume of funds to the Euro-dollar market. The Germans had been reluctant to do so until the sterling crisis, but in November and December they had poured in a great deal of money through forward operations. By and large, looking to the probable European credit needs of U.S. firms over the year, there probably would be pressures to have them financed in Germany; the German banks were anxious to get the business. Much would depend on the open market policies of the German Federal Bank and the Bank of Italy. At the Basle meeting, both the Germans and the Italians had indicated that they would be prepared to follow expansionary credit policies and to accept losses of reserves, and they had urged their European associates to follow the same course.

Mr. Mitchell observed that in his judgment the best way for the Europeans to avoid the competitive interest rate escalation they feared was to pursue policies that would make it unnecessary for the System to raise the Regulation Q ceilings. Specifically, they should supply sufficient funds to the Euro-dollar market to accommodate the demands from both European and American sources.

Mr. Coombs replied that he thought the Germans and the Italians were prepared to go far in that direction. A problem was likely to arise in connection with the Swiss, Belgians, and Dutch, who lacked the instruments necessary to substitute domestic for foreign assets as backing for the money supply when they lost reserves. As he had indicated, their tendency was to let their money markets tighten under those circumstances.

Mr. Mitchell then asked whether it was fair to say that Germany and Italy had the resources to help meet the problem in the Euro-dollar market but were reluctant to do more than what they considered to be their share.

Mr. Coombs replied in the negative; he had found the attitude of both countries to be highly encouraging. However, in the absence of some indication of the probable magnitude of the problem, it was difficult for anyone to make specific decisions.

> By unanimous vote, the System open market transactions in foreign currencies during the period December 12, 1967, through January 8, 1968, were approved, ratified, and confirmed.

Mr. Coombs reported that six System drawings on the National Bank of Belgium would mature soon. Of these, one for $8 million would reach the end of its three-month term on February 13, and he would recommend its renewal if necessary. The other five, which totaled $60 million, had already been renewed once, and at their various maturity dates between January 26 and February 8 they would have been outstanding for six months. Officials of the

National Bank of Belgium had assured the board of directors of that Bank that the drawings would not extend beyond six months except perhaps for a short grace period. He (Mr. Coombs) could not say whether there would be a sizable outflow from Belgium before those six-month drawings matured. If there was not and balances remained, he thought the best course would be to repay them with proceeds of a U.S. Treasury drawing on the IMF, and he planned to discuss the matter with the Treasury. However, the process of making the necessary arrangements with the Fund could be time consuming and there might be delays if the Belgians raised questions about possible concessions by the U.S. under its investment restraint program. Accordingly, he would suggest that the Committee accept the possibility that second renewals might be necessary in the case of some or all of the five drawings, on the understanding that the Account Management would do its utmost to get them cleared up as soon as possible.

> Renewal of the drawings on the National Bank of Belgium was noted without objection.

Mr. Coombs then reported that a $100 million System drawing on the Bank of Italy would reach the end of its first three-month term on February 2, 1968. There was some chance, if the Italians followed the cooperative type of policy they had indicated they would, that it would be possible to repay that drawing by the maturity date. He would recommend renewal if that did not prove possible.

> Renewal of the drawing on the Bank of Italy was noted without objection.

Mr. Coombs noted that four System drawings on the Netherlands Bank, totaling $100 million, would reach the end of their first three-month terms between January 25 and February 13, 1968, and unless there was sizable outflow of funds from the Netherlands it might be necessary to renew them. In addition, two drawings of $10 million each, which had been renewed once, would reach the end of their second three-month terms on January 26 and 31, respectively. He would hope that the outflow from the Netherlands would be sufficiently large to repay the $20 million involved. If not, he would recommend that the two drawings be renewed a second time, on the understanding that they would be cleared up as soon as possible.

> Renewal of the drawings on the Netherlands Bank was noted without objection.

As to drawings on the System, Mr. Coombs continued, a Bank of England drawing of $50 million would mature for the first time on February 7, 1968. He hoped the British situation would improve sufficiently to permit its repayment, but he would recommend its renewal if requested by the Bank of England. Also, two drawings by the BIS, totaling $48 million, would reach the end of their first three-month terms on February 13 and 14, respectively. He would hope that not only those drawings but other outstanding drawings by the BIS--which came to nearly $300 million--would be completely cleared up by the end of February. The BIS also thought that was a reasonable expectation. There was always the chance, however, that renewal of the two drawings would be necessitated by some unexpected development. Accordingly, even though that probability seemed slight, he would recommend their renewal if necessary.

Renewal of the drawings by the Bank of England and the Bank for International Settlements was noted without objection.

Chairman Martin entered the meeting at this point.

Mr. Coombs then referred to the System's outstanding technical commitments in forward lire, noting that he had been hoping for a turn in the Italian payments situation that would enable the System to clear them up. It was possible that such a turn would occur between now and early spring, in light of both expected seasonal deficits in their payments and the indications that the Italians would cooperate with the U.S. program. However, if the commitments were still on the books by, say, the end of March or April, he would propose that the System ask the U.S. Treasury to take them over. The System had $500 million in such commitments outstanding, and the Treasury might be somewhat reluctant to add those to its own forward lire commitments, which totaled $1,380 million. However, if the System's commitments were still outstanding this spring there was little likelihood that they would be discharged in subsequent months since seasonal forces would then be working toward surpluses in the Italian payments balance. Under such circumstances, he thought it would be more appropriate for the Treasury than for the System to carry the commitments. Moreover, the Treasury had indicated earlier that it would take them over if the System thought that it should.

Chairman Martin commented that the approach Mr. Coombs had suggested with respect to the System's forward lire commitments seemed to be a reasonable one. He suggested that the Committee plan on having the matter discussed with the Treasury if it did not prove possible to clear up the commitments by the end of March or April. No objections to the Chairman's suggestion were made.

Mr. Robertson entered the meeting at this point.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering domestic open market operations for the period December 12, 1967, through January 3, 1968, and a supplemental report covering the period January 4 through 8, 1968. Copies of both reports have been placed in the files of the Committee.

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

> During the period since the Committee last met financial markets became convinced that the Federal Reserve had moved toward a policy of monetary restraint; the increase in reserve requirements on December 27 was interpreted as confirmation of the firmer money market conditions brought about through open market operations. Nevertheless, despite year-end churning, indications of a strong economic performance, and heavy gold losses, a significant improvement in sentiment appeared to be under way in the capital markets. This better sentiment was reflected in the willingness of investors to commit funds at the high level of interest rates that had been attained earlier and appeared to be based on both technical and potentially more significant factors. Among the technical factors were the seasonal lull in the corporate calendar, the absence of Treasury borrowing, and the strong technical position of the Government securities market. Among the potentially more significant factors--which cannot be fully assessed at the moment--were the favorable reception accorded the Administration's balance of payments program, the market's apparent willingness to believe that there is hope for constructive developments in Vietnam, and some feeling that pressures on the economy might subside in the second half of 1968.
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> The market's initial reaction to the President's balance of payments program was one of relief that at last "something" had been done to relieve what had seemed to be a nearly intractable problem, with overtones of worldwide financial instability. Generally the market expected that the increased restraint on business firms and financial institutions with respect to their operations abroad would result in somewhat less pressure on domestic capital and other financial markets, and, moreover, would take some of the pressure off monetary policy. There is concern, however, about the Government's tendency to move in the direction of direct controls, and the market will be paying strict attention to the Administration's budget proposals and Congressional attitudes towards the tax bill in the

period immediately ahead. The returns are thus not yet all in on the impact of the payments program on domestic financial markets, but the initial reaction has been better than might have been expected.

There is, of course, lingering uncertainty about the impact of the payments program on the Euro-dollar market, and how developments there may interact with domestic financial markets and domestic interest rates. Generally, the expectation is for considerable pressure on the Euro-bond market, as domestic corporations try to finance a still higher proportion of their foreign investment programs abroad. How the availability of Euro-dollars used by U.S. banks to finance domestic activity will be affected is less certain. Much will depend on the willingness and ability of foreign investors to expand their short-term dollar holdings and on official policy, as Mr. Coombs mentioned earlier--and this in turn will depend on whether confidence in the dollar can be strengthened. Attempts by U.S. banks to shift foreign loans to their European branches will also be an important factor. Developments in this area will bear close watching. So far, however, past seasonal patterns do not appear to have been unduly distorted.

As far as open market operations are concerned, I have little to add to the written reports. As indicated there, operations were designed to bring about a moderate but distinct firming of money market conditions as evidenced by the Federal funds rate and lower free reserve figures. Extensive use was made of repurchase agreements during the period to keep the banks on short rein, but none were left on the books by the close of the period yesterday except for a modest amount against bankers' acceptances. Bill purchases totaled about $650 million during the period, with nearly 80 per cent of that total purchased from foreign accounts, again illustrating the importance of large foreign transactions for domestic open market operations.

As far as the visible results of open market operations are concerned, free reserve levels and the Federal funds rate turned out well within the ranges discussed at the last Committee meeting. Member bank borrowings from the Reserve banks, on the other hand, were substantially higher than would ordinarily be associated with these two measures. But, as the blue book[1] points out, the level of borrowings was influenced by year-end developments, and excess reserves--particularly at money market banks--were undoubtedly higher than many of the banks really desired. I should note that in the current statement week, free reserves are running above recent levels although the Federal funds rate has been under upward pressure. This appears to be the result of a seasonal tendency for country banks to run up excess reserve levels in this particular statement week and thus immobilize reserves that are in the banking system. I would suspect that in the next statement week a very low level of free reserves--possibly even the emergence of a net borrowed reserve figure--would be consistent with relatively unchanged money market conditions as these excess reserves are put to work by country banks in the second week of their statement period.

Despite the fact that the markets are convinced that the System has tightened policy, interest rates--particularly long-term rates--have been dominated by the market psychology referred to earlier. Interest rates on intermediate- and long-term Government securities have actually declined by 1/4 per cent or more, with the price of the bellwether 4-1/4 per cent Government bonds maturing in 1987 - 1992 up by about 4-1/2 points since the time of the last meeting. The corporate bond market--which will meet its first significant test of 1968 tomorrow with bidding on a $100 million telephone issue--has had a similar reaction. Even the municipal market, where dealer inventories had been heavy and investment demand unenthusiastic, took on a better tone by the close of the period. Whether or not this better sentiment can be maintained depends heavily on development regarding Vietnam and fiscal policy. It is certainly likely that unfavorable developments in those areas would turn the situation around rapidly with possible whip-saw effects on the markets. But in the present state of euphoria the announcement of a Federal National Mortgage Association participation

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

certificate financing has been enthusiastically received and no one anticipates problems with the Treasury's routine offering of $2-1/2 billion June tax-anticipation bills which will be auctioned this afternoon.

Short-term interest rates were somewhat less affected by market psychology. At the end of last week rates moved down sharply, bringing rates on the 6-month and one-year bill down 20 - 25 basis points below levels prevailing at the time of the last meeting. In yesterday's regular Treasury bill auction rates of 5.08 and 5.376 per cent were established on three- and six-month bills, respectively, up 14 and down 11 basis points from rates set in the auction held the day before the last meeting. In today's auction of June tax-anticipation bills the market is anticipating a rate of 5 - 5-1/8 per cent, with the tax and loan account value estimated at the equivalent of 45 - 50 basis points.

As far as bank credit is concerned, the credit proxy in December showed little change, in contrast to the 2 - 5 per cent growth rate anticipated at the last meeting. There appeared to be some expansion in business loan demand around year-end--although part of it related to special seasonal borrowing for tax purposes--and the blue book estimates a resumption of growth in January at an annual rate of 6 - 10 per cent.

As noted earlier, the Treasury is raising $2-1/2 billion in cash today and will need additional cash in both February and March. At the end of the month, the Treasury will announce the terms of its February refunding of $2.6 billion maturing Treasury notes. Most likely the Treasury will use this opportunity to raise additional cash--perhaps as much as $2 billion--although given proper market conditions a prerefunding of heavier maturities later in the year cannot be ruled out. Even keel considerations will consequently be with us at the time of the next meeting.

There are two technical matters that I would like to touch on. First, as many of you have no doubt noticed, as the System gold ratio has gotten closer to 25 per cent we have had, under current procedures, to adjust participations in the System account almost daily to prevent individual banks from falling below the 25 per cent minimum. At some point we might want to move to a routine reallocation of the account to

> equalize gold ratios at each Reserve Bank on a daily basis. Secondly, last Friday under a new Treasury regulation, Treasury securities held by the Federal Reserve Bank of New York for account of member banks were converted to book-entry form, and I gather the same process is under way at other Reserve Banks. Treasury securities held for various Government investment accounts are expected to be converted to book-entry form shortly. It would seem reasonable to convert the System open market account in a similar manner and we are asking counsel for the Committee to look into the legal side of the matter.

By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period December 12, 1967, through January 8, 1968, were approved, ratified, and confirmed.

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

Mr. Partee presented the following statement on economic conditions:

> The economic data becoming available over the past month confirm that a strong post-strike resurgence in activity is under way. The employment figures are especially impressive. Nonfarm employment, which rose 200,000 last month and was revised upward by this much more for November, was nearly 1 million higher in December than in August, just before the auto strike. And the unemployment rate will be reported tomorrow to have dropped by another 0.2 last month, to 3.7 per cent. Other measures, including industrial production and manufacturers' new orders, have also shown large gains recently, and personal income has spurted dramatically upward with the Federal pay raise, the return of strikers

to work, and the gains in activity and employment noted. Unfortunately, prices also have moved up another notch, at both the consumer and wholesale levels, though the rate of rise in unit labor costs recently appears to have been moderating cyclically.

The staff projection for this quarter, detailed in the green book,[1] calls for a $20 billion increase in GNP. The essential features of this forecast include an acceleration in consumption, reflecting the large additions to the income stream; a sharp pickup in plant and equipment expenditures, as indicated by the most recent Commerce-SEC survey; and a further increase in the inventory buildup, as new car inventories are rebuilt and steel stockpiling progresses. Residential construction expenditures also are expected to move somewhat higher, even though housing starts may turn down this quarter, but defense expenditures are projected to level off. Over one-third of the dollar increase in GNP may be accounted for by higher prices, as the deflator is projected to continue rising at around a 3-1/2 per cent annual rate.

I find it hard to fault this projection, or to make a convincing case that, in the absence of a tax increase, the second-quarter number would be appreciably smaller. With the large injections of income in process and still to come, the normal post-strike reaction in automobile and related output, and the positive inducements to carry higher inventories in key areas, the economy gives every appearance of building up a considerable head of steam. It may be that consumers are cautious and apprehensive about inflation, as indicated by the recent surveys. But it would be risky indeed to predict that the savings rate will go much above the more than 7 per cent rate now projected. It may be that the upturn in plant and equipment is not yet broadly based; half of the total increase planned, between the fourth and first quarters, is accounted for by the public utilities. But with industrial production rising and strong cost inducements to economize on labor, it is not hard to see a basis for growing capital outlays as the year progresses. It may be that current stock-sales ratios appear quite high in some lines, but this seems unlikely to preclude a considerable amount of inventory accumulation over

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

the first half if activity is rising as sharply as expected.

More broadly, it seems to me that there are three main developments that could conceivably moderate the inflationary impetus of the economy in the months ahead--each uncertain at this time. The first is the possibility of a cessation in U.S. bombing and the beginning of peace negotiations in Vietnam, which has been the focus of another flurry of speculation in recent days. These steps might not lead to an immediate cessation of hostilities, but still they would have important implications for the economy. Not only would such a development tend to limit increases in defense spending, and hold out the prospect of eventual cutbacks, but also the immediate impact on private attitudes, plans, and expenditures doubtless would be substantial and varied. This possibility, though remote, would of course require a prompt reassessment of economic policy, and needs constantly to be kept in the background of the Committee's thinking.

The second possibility is that we might really get a substantial measure of fiscal restraint this year, including a tax increase in the spring and a continued hold-back by the Administration on expenditures. As for the tax increase, prospects seem to have improved from the very low ebb reached a month ago, though a better reading should be possible when the House Ways and Means Committee resumes hearings later this month. Similarly, release of the Budget document at the end of this month will provide a clearer view of the Administration's spending intentions. Meanwhile, however, it may be noted that the Federal deficit, on a national-income-accounts basis, is declining substantially as a result of the spending hold-back and increasing revenues at current tax rates. If the 10 per cent tax increase goes through, the N.I.A. budget for the second and successive quarters could be moving into surplus.

The third possibility for moderation in the economic outlook is that financial conditions are now, or could soon become, taut enough to restrain private expenditures importantly and perhaps also to de-escalate presently bullish expectations. Flows of funds through the financial institutions have diminished markedly in recent weeks and interest rates in the market remain at very high levels by historical comparison. Moreover, there is still considerable uncertainty regarding possible future financial developments, both domestically and internationally. At the least, present financial conditions are likely to lead to a gradual cutback in housing and in the marginal expenditure plans of businesses and governmental units. But it is also conceivable--though certainly not demonstrable at present--that uncertainties could become strong enough to lead to a broadly based shift in public preferences toward financial liquidity and away from current purchases. Any such tendency for a "crisis" atmosphere to develop could serve to sap the strength of the economic resurgence that otherwise seems so assured.

Substantial financial restraint is clearly called for in the current inflationary economic environment. But we need to be alert against the possibility that monetary policy, in interaction with other forces, could lead to unduly restrictive financial conditions that might jeopardize the economic expansion itself. And we need to be especially aware now of the lagged impacts of financial conditions on expenditures. These may serve to focus increasing restraint on spending next spring and summer, at the very time when a possible tax increase might also be taking effect. I am doubtful that the economy is strong enough to withstand sizable further doses of both monetary and fiscal medicine.

All of these considerations lead me to advise that the Committee be prepared to wait for a while before taking additional steps toward monetary restraint. In a few weeks, we will know a good deal more about the course of Federal spending, the prospects for a tax increase, and the hopes (if any) for a near-term change for the better in Vietnam. And we should be able to evaluate more clearly the effects on the economy of the tightening in financial conditions already set in train. I am fully aware that no change now will probably mean no significant change until at least early March, in view of the Treasury's February financing. But I believe that the degree of monetary restraint already achieved provides a meaningful check on the possibilities for further acceleration in the economy over this period.

Mr. Axilrod made the following statement regarding financial developments:

The impact on financial markets and the economy from the interaction of tighter open market policy and discount rate and reserve requirement increases can be assessed in light of the emerging structure of interest rates, the degree of credit availability from banks and other financial institutions, and the liquidity position of spending units. The various monetary actions have been accompanied by a decline in long-term interest rates, apart apparently from those on mortgages, to levels below November-early December peaks. Meanwhile, since mid-November, short-term interest rates in general have risen about 25 - 50 basis points or so on balance.

The tilt in the structure of interest rates in face of the monetary measures taken is explainable mainly in terms of expectations. The monetary actions have been quite mild, and so mild a move was already largely discounted by credit market participants. Moreover, with bond markets already favorably disposed toward a rally in view of the holiday lull in new corporate and municipal issues, there was a strong downward impact on interest rates from the balance of payments program and rumors of peace negotiations. Both were interpreted as reducing the likelihood of significant further monetary stringency. Of course, peace rumors particularly can readily prove to be evanescent, and market psychology could turn adverse about as rapidly as it turned favorable.

While pressures on long-term markets appear to be somewhat diminished at the moment in view of the shift in market attitudes, the sustainability of such reduced pressures will in practice depend partly on the extent to which banks and other lending institutions may be forced to withdraw as suppliers of funds to long-term markets. The rise in short-term interest rates since mid-November has been accompanied by smaller net increases in time and savings deposits of banks and of similar accounts at other savings institutions. Moreover, fragmentary information we have seen (including reports from Federal Home Loan Banks on estimated experience of S&L's during the past few days) would appear to indicate that the year-end reinvestment period has confirmed the tendency toward reduced net inflows of time and savings accounts, but without indicating a sharp further deceleration in such flows. One might hazard the view that the availability of funds to banks and other institutions is not currently becoming so restricted as to occasion severe dislocations in mortgage lending, or in lending by banks to businesses. However, the flows of funds into financial institutions appear to have declined enough not only to maintain existing tautness in institutional lending terms but also to bring into question whether savings institutions, particularly commercial and mutual savings banks, will be able to provide as much funds to the municipal and corporate bond markets as they have in recent months.

The somewhat improved liquidity position of banks and other financial institutions has enabled them to adjust rather smoothly to the reduction in inflows of consumer and corporate funds. For nonbank savings institutions, particularly savings and loan associations, liquid asset holdings (net of borrowings) are rather comfortably above levels in the first half of 1966, before the very large drains in deposits of that year began. But thrift institutions, as well as building up liquidity, have been relatively prudent in extending themselves through commitments. During recent months, outstanding mortgage commitments have expanded at a markedly slower pace than earlier in 1967, partly because such commitments had already been built up to high levels but also because of uncertainties about savings flows in a period of rising short- and intermediate-term interest rates. The reduced flow of commitments does indicate a reduced rate of growth in construction outlays for the months ahead.

With respect to banks, their liquidity position--measured diversely by loan-deposit or various liquid asset-deposit ratios--appears to have been improved enough so that they have been prepared to see a moderate CD run-off without being quite as aggressive as they might have been in either the CD or Euro-dollar markets. Instead, banks used up some of their restored liquidity in accommodating the very large business loan demands of last month. But the liquidity of banks is comparatively limited against standards of earlier years, and they are unlikely to be able to accommodate continued relatively strong business loan demands without withdrawing further from securities markets or becoming more aggressive bidders for funds in Euro-dollar, CD, and Federal funds markets. As they withdraw, the resulting maintenance of relatively high interest costs to State and local governments may lead to postponements, at the margin, of financing and spending plans of such units, as has been the case in the past.

The odds do favor a relatively strong business loan demand on banks in the months ahead, generated in large part by inventory rebuilding. Moreover, corporate liquidity remains quite low, though improving contra-seasonally in the third quarter; and businesses have rather less scope than in past years to accommodate finance needs out of existing liquid asset holdings.

The bulk of last year's $11 billion increase in the money supply appears to have moved into the hands of consumers, rather than businesses, as best as that can be measured from the fragmentary data available. The growth in money holdings and other liquid assets held by consumers was rapid enough last year to lead to a rise in the ratio of such assets to disposable income to levels somewhat in excess of the previous two years. Thus, in the conjectural degree that liquid asset holdings affect consumer spending--and evidence on this point is mixed--consumers appear to be in an improved position to increase their outlays even in face of the monetary restraint in process.

Nevertheless, the over-all condition of financial markets seems taut enough to require no additional monetary restraint at the present time, given the economic outlook and reduced stimulus to be expected from the Federal Government even without a tax increase. One might even note that the financial position of all key economic sectors--except possibly consumers--has little enough slack to it so that one should be very cautious about placing too much additional restraint on the financial system. Some additional restraint is likely to develop in any event from an open market policy that holds money market conditions at levels that have come to prevail in recent weeks. This will probably gradually force financial institutions, corporations, and consumers to reduce their liquidity if existing spending plans are to be effectuated. As they do so, and as additional spending becomes even more dependent on new credit, the financial restraints on spending will tend to become even more effective.

Mr. Brimmer asked about the volume of large-denomination CD's maturing in January, and about expectations with respect to changes in total outstandings in that month.

Mr. Axilrod replied that $5.9 billion of large-denomination CD's would mature in January, about the same as in December. The staff's present expectation was that total outstandings would remain essentially unchanged. Since there ordinarily was an increase in outstanding CD's at this time of the year, no change in the total would, in effect, represent a decline on a seasonally adjusted basis.

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

> As Mr. Coombs has already reported, the announcement of the new balance of payments program has transformed the international scene, at least for the moment. It has calmed the gold market and strengthened the dollar against continental European currencies despite a flood of bad news announced at about the same time--news that included poor trade figures for November, a large increase in the payments deficit during the fourth quarter, and a further gold loss of $450 million at the end of December.
>
> Obviously the new program is a tough one, particularly in its restraint on capital flows. We can expect it to cut the liquidity deficit by a substantial amount in 1968, though probably not by the full $3 billion cut assigned by the President to particular items, since some of the new measures will take time to implement and some will generate partly offsetting feedbacks.
>
> The question I want to explore this morning is this: What kinds of developments, here and abroad, would be needed to make the new program a more lasting success than its predecessors? To start with, what responses from continental Western Europe, towards which the program is particularly aimed, would be most constructive?
>
> The main thing we want the continental countries to do, I think, is simple but not easy. We want those countries to acquiesce in the shrinkage or disappearance of their chronic payments surpluses; indeed, we want them

to accept reserve losses, at least for a time. For if both the United Kingdom and the United States succeed in achieving adjustments on the scale they are aiming at--more than $4 billion a year for the two countries combined--there will not be room to carve all this out of the continent's $2-1/2 billion surplus. Some of it may come out of the surpluses of third countries, but probably at least a few European countries have to begin losing reserves.

One by-product of this possibility may be a heightened interest in Europe and elsewhere in giving early birth to Special Drawing Rights in the International Monetary Fund, so as to provide an increase in would reserves. Last week, the IMF Executive Board completed its first reading of the proposed SDR amendment more quickly than had been expected, and it seems likely that the new U.S. payments program was a contributing factor.

We want Europe to maintain a high level of economic activity, higher than in the recent past. Hence we would hope that the European authorities would attempt to offset any damping effects that the new U.S. measures may have on activity there, and would, as Mr. Coombs discussed, help their credit markets--both the national markets and the Euro-currency markets--to meet the new demands thrust upon them.

The capital outlays of U.S. affiliates in Europe are estimated to account for about 7 per cent of total plant and equipment expenditures there, and the share we have been financing--and are now asking Europe to finance--comes to only about 2 per cent of such outlays. In dollar terms, the sum involved in our direct investment cuts is about $1 billion. Half of that sum might be fairly readily absorbed by the Euro-bond market if it continues to expand at recent rates, and it would seem that the remainder might be handled in national or Euro-currency markets without great difficulty. The cutback in U.S. bank credit under the voluntary foreign credit restraint program will create additional pressures, but some of this will no doubt be handled by a transfer of loan business from U.S. head offices to their foreign branches.

In addition to maintaining a high level of activity in Europe, and avoiding an undesirable tightening of credit conditions, we would, of course, also like the Europeans to be imaginative about doing other constructive things--such as dismantling restrictions and reconsidering border taxes, and even contributing more to mutual defense costs.

Most of the reactions we hope for in Europe would be in Europe's own interest as well as ours, provided that the fetish of reserve gains is not allowed to take priority over economic welfare. No one can guarantee the European response. But at least the new program sets up some of the right incentives. And we are now much better placed to press the case for reasonable solutions. Having acted on the balance of payments, and in particular having adopted European advice with regard to cutting direct investment outflows, we can now fairly claim that it is the surplus countries' turn to shoulder their responsibilities.

It is to be hoped that the new U.S. restrictions on capital outflow, like those of the earlier VFCR and Commerce Department programs, will serve to hasten the broadening of European capital markets--both local and international--which everyone agrees is needed in the long run. No one who has lived with the new restrictions for even the past few days would advocate them as a permanent way of life. Sooner or later they must go. The hope is that when they do, we shall have bought not merely a little more time, but also better-functioning credit markets abroad that can make an enduring contribution to international balance and to the development of the less developed world.

Still, a good part of the program does consist of buying time. This is clearly so for the bank credit reflow sought under the tighter VFCR guidelines; this will by nature be a one-shot gain. It is true also for whatever temporary restraints are placed on American travel outside the Western Hemisphere. It makes sense to buy time only for two things: an ending of the Vietnam War, which is now costing something like $1-1/2 billion a year in balance of payments terms; and an eventual improvement in the U.S. competitive position and hence in the trade balance.

For the long run, the U.S. competitive position is still the crucial variable. It has become even more crucial than before, now that we have used up most of our other options, short of a change in the present exchange rate system. In announcing his program, the President tried to make clear that restraint of domestic

> inflation was the first and most essential element of it, but this feature seems to have escaped the attention of a good many analysts. Indeed, there was even a suggestion in some market reports that now that we had harnessed capital outflows, the Government and the Federal Reserve could be more relaxed about domestic inflation.
>
> Nothing, in my view, could be further from the truth. Even if we should press for reform of GATT rules and should adopt, as is now being confidentially discussed with other governments, small export rebates and import surcharges of the order of 2 per cent or so--a course of action about which I personally would have serious reservations--the competitive shot in the arm that this would give us would be wiped out in less than a year by a continuation of present rates of price advance. Given the understandable dislike for inflation in other industrial countries, there is simply no substitute for slowing the rise of our costs and prices. Only if we can do so have we any hope of getting back into international balance on a sustainable basis at present exchange rates.

Chairman Martin expressed the view that the staff reviews this morning had been excellent. He then called for the go-around of comments and views on economic conditions and monetary policy, beginning with Mr. Hayes. After concurring in the Chairman's observation, Mr. Hayes made the following statement:

> Since our last meeting the most important event bearing on the economy has been the President's announcement of a vigorous and comprehensive new program aimed at a major improvement in the U.S. balance of payments. While some of the details may be open to criticism, we can only applaud the program as a whole. It was finalized in the nick of time; without it the dollar might now be under at least as severe an attack as those of late November and mid-December. On balance it seems to me that the program has been rather well received, especially in view of the extent to which mandatory controls have been either initiated or

authorized. Much as I welcome the program, however, I would be the last to argue that it constitutes a permanent cure for our payments difficulties. We are far from being "out of the woods", and international considerations must continue to play an important part in the determination of our own policies.

This conclusion is underlined by the drastic deterioration in the payments deficit for the fourth quarter. Admittedly the liquidation of British holdings of Federal agency securities contributed significantly to the deterioration, but in a way this was merely a dramatic demonstration of the danger of relying so much in recent years on the beneficial effects on the liquidity deficit of various "cosmetic" adjustments. The trade surplus was disturbingly low in October and November, and the renewed domestic expansion may presage a new surge in imports. The poor fourth-quarter results may also reflect transfers of funds by U.S. corporations to their affiliates abroad in anticipation of the new balance of payments program.

While the new balance of payments program is designed to yield savings of close to $3 billion, it is by no means certain that savings in this magnitude may actually be achieved, and there may be important offsets because of adverse effects on our trade surplus of the accelerating domestic expansion and perhaps of the direct investment program itself.

As for the domestic business situation, the strengthening of economic activity in the final two months of 1967 was considerably more than could be attributed solely to the improved strike picture. Virtually all recent data confirm the likelihood of a very strong first half, whatever happens on the fiscal front. Current inflationary pressures are likely to increase, with serious implications both at home and abroad. Visibility for the second half of the year is of course cloudy, but the absence later in the year of some of the special stimulating factors expected in the first half may only mean reduced overexuberance. There is still major uncertainty with respect to tax legislation, and in the absence of a tax rise, demand could turn out to be excessive throughout the year. It seems to me likely that as a nation we have been seeking a somewhat faster rate of growth and a lower rate of unemployment than are consistent with cost-price stability.

There is some ground for satisfaction in the further evidence accumulating since our last meeting that the growth of bank credit and the money supply has slowed appreciably in recent months. This general conclusion seems valid despite a variety of seasonal and special factors which make analysis of the credit statistics unusually difficult. We should of course seek a much more moderate rate of credit growth than that which prevailed for 1967 as a whole; and with bank loan demand quite strong and Government financing needs still unusually large, the dangers probably continue to lie more in the direction of excessively rapid credit growth than inadequate growth.

So far the commercial bank experience with disintermediation is rather reassuring.[1] The December attrition of large CD's turned out to be smaller than the banks had expected. January could, of course, be a difficult month. So far, however, turn-of-the-year losses of time and savings deposits appear to have been generally moderate for most of the Second District commercial banks we have contacted. For the seven New York City banks covered, losses in passbook savings accounts were actually running somewhat below the previous year at most banks; indeed, two banks reported a net increase during the first two business days of 1968. Some New York City banks reported substantial losses of large CD's, but others expressed surprise at the moderate size of their own losses. A few banks in New York City also reported substantial losses of CD's of less than $100,000 denomination. At the 11 banks outside New York City included in the survey, the great majority reported no unusual outflows of either passbook savings or of other time deposits. The situation with respect to the New York City savings banks is less

[1] On December 20, 1967, Mr. Holland had sent a telegram to all Reserve Bank Presidents, reading in part as follows: "In view of interest in subject of possible year-end disintermediation expressed at December 12 meeting of Federal Open Market Committee it is suggested that Reserve Bank staffs contact a number of representative member banks in their respective Districts early in January to obtain information on developments with respect to time and savings deposit flows around year-end interest crediting period, and that Reserve Bank Presidents plan on summarizing results of such inquiries in the course of their comments at January 9 meeting."

> reassuring than that of savings-type deposits of the commercial banks. The entire credit situation obviously calls for a continued cautious and watchful attitude.
>
> On both domestic and international grounds the economy needs additional restraint, but that restraint should come now in the form of appropriate fiscal policy. In the last few weeks all three instruments of general credit policy have been used to support a move toward moderately firmer monetary restraint. We should, I think, sit tight for the time being and avoid any risk of credit "overkill", particularly as we are awaiting the President's Budget Message and fiscal developments in Congress. By the time of our next meeting we should have a much clearer view of these prospects. Even keel considerations are likely to confront us during much of the next two- or three-month period, but there should be short intervals when some further monetary restraint can be squeezed in if it is needed, as it may well be.
>
> For the next four weeks open market policy might appropriately aim at preserving the status quo, with special emphasis on a Federal funds rate of, say, 4-5/8 per cent and occasionally higher. Perhaps free reserves might range between zero and $150 million, but I would see no reason to object if free reserves became negative at times. Borrowings might tend to exceed the levels of a few weeks ago, although falling below the high figures of the year-end period.
>
> As for the directive, alternative A of the staff drafts[1] is acceptable. In interpreting the proviso clause, I would be less concerned with deviations of credit growth on the low side than on the high side.

Mr. Ellis said that in view of the renewed vigor of economic expansion and the accompanying likelihood of expanding credit demands from the private economy at a time when monetary policy was firming, it was appropriate to focus attention on financial flows at year end as suggested in Mr. Holland's wire.

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

On January 4 the Boston Reserve Bank surveyed by telephone the large member banks and mutual savings banks located in Boston and major cities in the District. The member banks located in Boston reported that savings flows during December slowed for both regular passbook and special savings plans. Throughout the District optimism was expressed in regard to large CD's, with the banks expressing expectations that they could roll over or replace most maturing CD's. The December run-off of large CD's was regarded as normal and within the range of expectations.

The mutual savings banks located outside Boston, Mr. Ellis continued, checked in with much the same story--near normal deposit gains in December and no unusual changes anticipated in January. The large Boston mutual savings banks, however, reported a December net inflow of only $3 million, substantially below last year's deposit gain of $8 million and the 1962-65 average gain of $14 million. To some degree that pessimistic December experience might have been caused by a switch during the year 1967 from quarterly to monthly interest payments. Apparently some savers who in past years would normally wait until after the January quarterly dividend date to withdraw funds to pay Christmas bills were led to withdraw this year in December without loss of dividends.

Mr. Ellis commented that New England life insurance companies painted an optimistic picture for the present and future availability of mortgage funds in their most recent reports to the Reserve Bank. The 10 largest companies projected that policy loans during the first quarter of 1968 would increase at only about one-half the rate experienced during the first quarter of 1967. Actual policy loans granted in the fourth quarter of 1967 were 10 per cent below the third quarter of 1967 and increased at only one-third of the rate experienced a year ago. An expansion of mortgage payments into New England life insurance companies during the first quarter of 1968 was also projected; expected mortgage payments in the first quarter of 1968 were 20 per cent above actual payments in the fourth quarter of 1967.

In summary, Mr. Ellis said, his evidence supported the green book conclusion that "none of the data . . . suggest that thrift institutions are facing drains in January of very major proportions."

The staff analysis of changes in bank liquidity led Mr. Ellis to comment that member banks in New England had reduced their loan-deposit ratios from two points above the national average last December to just about par with the nation in December 1967. However, in contrast to the slight improvement nationally in liquid asset ratios, First District member banks ratios had declined about 10 per cent in the past year. It also was interesting to note that the eight largest banks in New England had shown a greater willingness to acquire their reserves through borrowing of Federal funds, negotiable CD's, or borrowing from the Federal Reserve Bank. During December 1966, when the eight largest New York City banks were borrowing 140 per cent of their required reserves in those ways, only three of the First District's largest banks borrowed larger percentages of their reserves. Last month, however, six of the eight largest banks in New England borrowed in excess of the now higher 160 per cent average for the eight largest New York City banks.

Turning to monetary policy, Mr. Ellis said he would like to start with the proposition, suggested by Mr. Reynolds' comments today, that improvement of the U.S. competitive position should be a principal target of both domestic economic policy and the special balance of payments program. He (Mr. Ellis) would question the widely accepted view that current price increases largely reflect cost-push pressures and the related argument that monetary policy cannot be utilized to restrain current inflationary pressures. He would note three considerations which indicated that that view should be modified.

First, Mr. Ellis observed, after a long period of rapid expansion in industrial capacity, growth of employment, and shifting of labor force from industrial to service occupations, the constraint of a tight labor supply might well bring demand-pull up to effective capacity limits in specific industries well before the traditional threshold limits of 90 or 92 per cent of capacity were reached. In that connection, it had been reported this morning that the unemployment rate was now down to 3.7 per cent. Second, some degree of demand-pull existed in any situation in which spending was maintained by dependence on rates of credit creation in excess of real growth--a situation that had prevailed and seemed likely to continue. Third, any price increase decisions contained an element of expectation concerning the future course of demand and the availability of credit to stimulate that demand. General awareness that monetary policy was going to be utilized with determination to restrain inflationary pressures must inevitably deflate some overexuberant expectations.

Those considerations persuaded Mr. Ellis that--without any pretensions that monetary policy could or should try to do the whole job--the System had made a wise beginning in starting to firm monetary policy. But it had only started the process. Now the System clearly should hold to the firming course that had been signaled and accepted. He, too, admired the staff reviews that had been given this morning, and found substantial areas in which he could agree with the staff analysis. However, he disagreed with some of the conclusions. For example, Mr. Partee had expressed the view that substantial financial restraint was clearly called for in the current inflationary environment. He (Mr. Ellis) would question whether it had been achieved. The discount rate increase had been a defensive measure. The reserve requirement increase had been a substitute for otherwise needed seasonal open market operations. The increase in market rates related to those actions had been minimal and largely reflected expectations that open market operations would in the future be directed toward validating the signaled firming in policy. He would agree with Mr. Axilrod's observation that the monetary actions taken were quite mild and had already been largely discounted by market participants.

Mr. Ellis noted that the staff's bank credit projections highlighted both the one-month interruption of growth in December, when the Treasury was out of the market, and the expected resumption of growth at an 8 per cent annual rate in January, when Treasury financing resumed. The projected spurt in growth of total reserves in January to a 19 per cent annual rate should readily offset the one-month decline of December. Financial markets here and abroad were waiting to see if the Committee's policy course would reflect determination to restrain credit growth. One signal to that effect would be a willingness to allow net borrowed reserve figures to appear, at least occasionally.

Mr. Ellis remarked that alternative B of the draft directives clearly postulated such action. He thought that the target range for net reserves of zero plus or minus $50 million, coupled with a corresponding $50 million increase in average borrowings to the $200 - $350 million range, would have less rate impact than the staff projected. That was because he believed present rate levels reflected some anticipation that the Committee's policy decision would be to move at least that far in terms of reserves. He would favor adoption of alternative B for the directive and he hoped the Committee would also.

Mr. Irons said he would not comment on developments in the Eleventh District except to note that they reflected the same kind of expansionary movement as the green book reported was occurring nationally. In general, the major economic indexes for the District showed strength.

Mr. Irons observed that in response to Mr. Holland's telegram the Dallas Bank had surveyed 51 commercial banks in the District by telephone during the period from December 28 through January 4. Of the banks contacted, 17 were reserve city banks and 34 were country banks. In general, changes in time and savings deposits were found to be minimal, and in some cases the banks themselves were rather surprised when they saw their own figures. Time deposits of the 51 banks taken together increased during the period by about $27 million, a figure which represented 1 per cent of their total time deposits and 0.6 per cent of such deposits at all member banks in the District. The $27 million increase was concentrated in CD's of over $100,000, with most representing corporate funds but some consisting of public funds. Savings deposits at the 51 banks decreased by $17 million during the period, or by about 1.5 per cent. Information furnished by the banks indicated that about one-half of the $17 million outflow was shifted into higher interest rate CD's and--surprisingly--into demand deposits. The other half flowed to savings and loan associations and to the bond and stock markets. All major banks in the District were paying the 5-1/2 per cent maximum on CD's over $100,000.

With respect to national and international developments, Mr. Irons remarked that as usual conflicting forces were at work. Domestically, economic tendencies were very strong in almost all sectors, most noticeably in business inventories, plant and equipment outlays, and consumer expenditures. In his District attitudes in the business community were a little less disturbed than they had been earlier, but businessmen still anticipated inflationary developments. The amount of economic expansion expected by some members of the business community was, perhaps, greater than was likely to be realized. On the other hand, there were various sources of uncertainty that were likely to continue for a time, relating to such matters as Vietnam and Federal taxes and expenditures.

Mr. Irons said that the balance of payments situation remained unfavorable. With respect to the new program, the comments he had heard or seen in the press in his District were, without exception, highly favorable. There had been a widespread feeling that something had to be done to deal with the balance of payments problem, and while the program was not necessarily considered appropriate in all respects it had been well received as a step in the right direction.

Mr. Irons noted that the recent reserve requirement increase also had been well received in the District. The action had surprised some people, but he had seen no criticism of it in the District press.

Turning to policy, Mr. Irons said he would favor maintaining about the same degree of firmness in the money market as had prevailed during the past few weeks. He had been rather pleased with the nature of interest rate developments during the period and with the fact that the earlier nervous anticipation of further rate increases had lessened somewhat. The effects of the System's recent policy actions would be continuing for a time, and it seemed desirable to him to let a few weeks pass to evaluate them. Also, more would be known soon about the likely effects of the balance of payments program.

While he would recommend that the prevailing conditions in the money market be maintained, Mr. Irons remarked, he also would hope that if any errors were made they would be in the direction of firmness rather than ease. Any accidental slippage back into ease would have an unfortunate effect on market attitudes. He favored alternative A for the directive and would accept the description of prevailing money market conditions that was given in the blue book.[1]

Mr. Swan reported the Twelfth District also seemed to have shared in the further upswing of economic activity in the last few months of 1967. December employment figures for the District were not yet available, but the November figures reflected employment gains in all major categories, with the largest increase in construction employment. The aerospace industry was among those reporting a rise in employment, but the gain was quite moderate and considerably less than in the preceding year, and only small increases were projected for succeeding months through March 1968. The unemployment rate declined to 4.6 per cent in November from 4.8 per cent in October. Lumber prices and orders were very strong in November and December, apparently because of the increase in

[1] The blue book passage referred to read as follows: "Maintenance of the money market conditions that have evolved in conjunction with open market policy and the announced reserve requirement increase during recent weeks would appear to involve free reserves in a zero to $100 million range; member bank borrowings generally in a $150 - $300 million range; the Federal funds rate generally above the discount rate and most frequently in a 4-5/8--4-3/4 per cent area; and a 3-month Treasury bill rate in a 4.90 - 5.25 per cent range."

construction activity made possible by milder weather in other parts of the country, and because of lumber shortages in the Northwest.

The San Francisco Reserve Bank's check on District developments with respect to time and savings deposits over the year end led Mr. Swan to much the same conclusion as Mr. Irons had reached for his District; namely, that there had been no major outflows. The survey covered large banks in the five reserve cities of the District in the period through Friday, January 5. It was not certain that information for all of the banks' branches had been included in the reports but the canvass nevertheless appeared to be fairly comprehensive. The figures showed a small net decline in passbook savings deposits and a slight decline in large-denomination CD's outstanding, but a small gain in other time deposits of individuals, partnerships, and corporations. Public time deposits had increased substantially, but that was a seasonal phenomenon in the Twelfth District. In general, the results indicated that there was no immediate threat of any significant amount of disintermediation at banks.

A check with three major savings and loan associations in San Francisco gave about the same results, Mr. Swan continued. One interesting finding was that those associations had experienced a net decline in share-holdings of $3.8 million as of January 2 but of only $3.2 million as of January 5; apparently they had gained funds between the two dates. The associations indicated that that surprised them considerably since they had not expected to gain funds before the January 8 - 10 period.

As to policy, Mr. Swan said, given the current strength of the domestic economy, the immediate balance of payments situation, the reduced concern about extensive disintermediation, and the fact that the Treasury would be engaged in a refunding in February, he was somewhat inclined toward seeking a slight further firming of money market conditions at present. He would emphasize the word "slight"; certainly, he thought this was not the time for a substantial move. It was true that some of the effects of recent policy actions were still to come, but under present market circumstances a very slight further move could be accomplished without disruptive consequences.

At the same time, Mr. Swan said, he was not prepared to argue strenuously for the adoption of alternative B for the directive. That was because he did not find the difference between the money market conditions associated with the two alternatives in the blue book to be particularly great. However, he was disturbed by one aspect of the language of alternative A. That alternative called for maintaining the somewhat firmer conditions that had developed partly as a result of the "announcement" of an increase in reserve requirements. He did not like the implication that the effect sought from the reserve requirement increase was confined to its announcement effect and, consequently, that the impact on reserve positions would be fully offset by open market operations. In his judgment, some--but not all--of the impact of that action on reserve positions should be offset. He thought that was the course the market expected the System to follow.

Mr. Swan observed that the proviso clause of alternative B called for modifying operations if "bank credit appears to be expanding significantly less than currently expected or any unusual liquidity pressures develop." If alternative B was adopted he would favor a bank credit proviso formulated to guard against significant deviations in either direction, as in both the present directive and alternative A, or to guard against excessive expansion. He saw no good reason for the type of one-way clause in the draft, particularly since the risk of undue tightening was dealt with by the reference to "unusual liquidity pressures."

Mr. Swan's final comment related to the phrase in the opening sentence of the first paragraph of the draft directive referring to the prospect of "persisting inflationary pressures in the months ahead." The implied time span of that reference seemed to him to be too open-ended, particularly in the light of the uncertainties about the economic outlook for the second half of 1968. He would suggest that the language of the draft be revised to avoid that problem, perhaps by inserting the word "immediately" after "months."

Mr. Strothman reported that, as suggested by Mr. Holland, the Minneapolis Reserve Bank last week checked with 14 District banks and found that with one exception no unusual losses of consumer deposits were reported. A few of the smaller banks reported unexpected increases in the immediate post-interest period, and a few reported customers switching from passbook accounts to certificates. Most banks, though, reported no unusual decline either in passbook accounts or in certificates. According to the banks surveyed, customer interest in market securities was increasing, but evidently that interest had not so far expressed itself in unusual losses of consumer deposits. One of the large metropolitan banks did report a modest decline in passbook savings and a substantial decline in certificate savings. Actually, that bank had been losing certificate savings since early December, and felt that customers with accounts in the $15,000 to $100,000 range were switching to market securities.

The recently completed quarterly survey of Ninth District farm credit provided additional evidence, if any was needed, of a decline in farm incomes, Mr. Strothman observed. A large proportion of respondent banks reported farm incomes down from a year ago, and saw little chance of their increasing this quarter. A number of reporters indicated farmers expected to cut back planned expenditures. For retailers in the rural area, the outlook for sales of farm equipment and consumer durables was certainly not bright.

From the farm credit survey, Mr. Strothman continued, it appeared that interest rates on farm loans were increasing, even though country banks, well-supplied for the most part with liquid assets, were having no trouble meeting current demand. There apparently had been some increase in farm loan demand, both short-term and long-term. A good deal of refinancing was being done, it seemed, and many of the District's country banks were expecting increased loan repayment problems.

Turning to Committee policy, Mr. Strothman favored striving to maintain money market interest rates at their most recent levels. As always, he would prefer to use the Treasury bill rate rather than the Federal funds rate as a target. In any event, using some interest rate target had an important advantage, at least in present circumstances. One thereby avoided the perplexing question of whether, with a constant free reserve target, a change in reserve requirements could have any effect on the monetary situation. The recent past had in fact witnessed increases in market interest rates, and he would like to see the Committee capture those increases.

However, Mr. Strothman said, he would be opposed to doing more at this time. There was no longer any chance, he thought, of doing "a little" more. Market interest rates were too close to Regulation Q ceilings. And an increase in the ceilings on rates paid holders of large-denomination CD's, accompanied by further increases in market rates, would in his judgment be inappropriate now. If a surtax was not in the bag, the probability of getting one was slightly greater than it had been a couple of months ago. So, before pressing further, Congress should be given one last chance. The economic outlook was not so bullish as to require both the imposition of a surtax--or a 10 per cent surtax, anyway--and an increase in monetary restraint, thereby dramatically shrinking housing output again. He noted the need for longer-run concern in the face of the more bearish forecasts for the second half of the year. Although he did not share the apprehension indicated by some, he nonetheless recognized the need for proceeding with some caution until the shape of things to come in the latter part of 1968 was somewhat more discernible. He favored alternative A of the draft directives.

Mr. Strothman said he would not wish to conclude his remarks without commending the architects of the structure of the recent reserve requirement increase. The exclusion from the increase of the first $5 million of demand deposits was a step in the right direction.

Mr. Scanlon commented that evidence that had become available in recent weeks did not alter significantly his evaluation of the economic picture in the Seventh District. The uptrend in prices of manufactured goods--both hard and soft--and of services was still apparent. Strength in activity through the first half of 1968 was widely expected, as was some easing of demand in the second half of the year. Labor unrest in the District continued unabated. The steel inventory buildup was expected to gain momentum rapidly in the next few weeks, with order lead-times stretching out. Except for steel, however, inventory policies, both at the manufacturing and trade levels, were believed to be conservative and related closely to current needs.

Some observers in the District believed that production and sales of business equipment would decline in 1968, Mr. Scanlon said, but the more general view was that there would be a small rise in physical volume and an appreciable rise in dollar totals. Prospects appeared good for a rise in demand for trucks and trailers, but there was little hope among machinery and equipment producers for any sizable rise in sales. Demand for farm machinery was clouded by projections of lower farm income. Manufacturers of construction machinery were troubled by possible further cutbacks in the highway program. Sales of industrial machinery were hampered by existing margins of unused capacity in most industries, expectations of a corporate tax increase, and concern over the cost and availability of credit.

Mr. Scanlon observed that the Midwest participated fully in the surge of construction contracts in November, with all major categories except public works showing substantial gains from last year. The dollar volume of contracts in recent months had been the largest by far for any similar period on record. Retail sales apparently picked up strongly in the last pre-Christmas week. Gains over year-ago widened at both durable and nondurable stores.

As to demand for bank credit, Mr. Scanlon remarked that loan demand appeared to have firmed somewhat further, in line with expectations. But the recent gains in business loans were not broadly based, being largely to oil producers and seasonal borrowers, with loans to manufacturers of durables continuing weak. Meanwhile, most of the major District banks still appeared sufficiently liquid to accommodate credit demands. Liquidity that was built up last year in preparation for a possible squeeze would cushion some decline in CD money. Attrition had been under way and was continuing in negotiable CD's, but that appeared to have been expected and had caused no serious problems thus far. Nevertheless, bankers contacted recently in response to Mr. Holland's wire reported that the present ceiling had become a barrier to the offering of higher rates and appeared to agree that the situation would get serious should yields on 3-month bills reach the 5-1/2 to 6 per cent range.

The Chicago Reserve Bank's inquiries also turned up reports that some passbook money was moving into CD's, Mr. Scanlon continued, and that some savings customers and holders of small CD's were shifting funds into commercial paper and agency issues. That was causing so-called "back room" problems for some banks and securities dealers in handling the transactions. Spokesmen for several banks in Detroit and Milwaukee that credit interest on passbook accounts on or about December 1 indicated that savings deposits had declined for the ensuing month, contrary to expectations, or had otherwise fallen below projections. But none reported such developments to have become a matter of serious concern. Certain of the banks posting credits at year-end appeared to feel that results in the first few days of January were "not so bad" as they had expected, but were reluctant to judge results with any finality so soon after the interest date. Several respondents indicated that public funds recently had been moving out of the banks and into the bill market.

While information available at this time necessarily was fragmentary and impressionistic, Mr. Scanlon found no evidence that such shifts as had occurred either in the closing weeks of 1967 or in the first few days of the new year were disturbingly large. Nevertheless, considerable concern was expressed over likely developments in coming weeks if market rates were to strengthen substantially and Regulation Q were to be maintained in its present form. The large money market and other banks that already had exploited the full range of alternatives open to them under Regulation Q--in terms of rate-maturity-denomination packages--were the most apprehensive. Those banks that still had some leeway under the Regulation appeared to be relatively less concerned.

As had been indicated, Mr. Scanlon said, all aggregate monetary and credit series had slowed noticeably since the last meeting of the Committee, consistent with the intent of the directive issued to the Manager of the Open Market Account. However, current staff projections indicated some revival of higher rates of growth in January. He believed that the Committee should attempt to continue to provide reserves consistent only with the more moderate rate of growth in credit that had been experienced recently and guard vigorously against dramatic changes in either direction. Continuation of inflationary pressures made more rapid rates of expansion inappropriate, while further curtailment of growth rates might be disruptive.

Accordingly, Mr. Scanlon concluded, he would recommend that the Manager conduct operations to avoid a revival of the faster rates of growth in money and credit. He could accept either draft directive. He believed the important thing at this point was that the Committee not loosen the reins on the firmer conditions it had achieved in recent weeks. If he understood the intent behind it, he believed alternative A did that though, like Mr. Swan, he would not want to see the Committee completely offset the reserve requirement change; he, too, thought the market had anticipated some slight additional firming as a result of that move.

Mr. Clay reported that twenty member banks in the Tenth District had been interviewed with respect to time and savings deposit flows of funds around year-end. In general, it appeared that most of the banks experienced no significant outflows of funds at that time. Four of the twenty banks surveyed were exceptions to that generalization, although the degree of disintermediation experienced in those four cases apparently was relatively minor.

Turning to the national situation, Mr. Clay commented that the United States continued to be faced with serious domestic and international problems requiring a considerable measure of restraint. The domestic economy appeared to be headed for substantial expansion of aggregate demand for goods and services in the next several months. That added demand came at a time when the country already was in the midst of serious price inflation.

Those developments were of particular concern in connection with the deficit in the U.S. international balance of payments, Mr. Clay said. The results to be derived from the recently announced emergency balance of payments program necessarily were quite uncertain at this stage. Whatever merit that program might have in providing time for adjustment, the competitive international trade position of the United States and the cost-price developments affecting it must continue at center stage in public policy.

Mr. Clay noted that the System had taken several steps toward monetary restraint in recent weeks. How far monetary policy should go at any given time necessarily was a matter of judgment of the circumstances and the policy impact. While the Federal Reserve must refrain from trying to make monetary policy do more than it could do constructively, some further firming cautiously pursued seemed to be in order. Such a policy might be described in terms of the complex of money market conditions outlined on pages 7 and 8 of the blue book.[1]

[1] The blue book passage referred to read as follows: "Should the Committee wish to move further in a restraining direction, it may consider a net reserve position for banks fluctuating around zero (between, say, plus $50 million and minus $50 million), a rise in borrowings to consistently in a $250 - $350 million range, and a Federal funds rate averaging around 4-3/4 per cent, with occasional trades at 5 per cent. Such conditions will probably raise new dealer loan rates in New York from their recent 4-3/4--4-7/8 per cent range to 5 per cent or better. And as a result, bill rates, especially short-term rates, are likely to adjust upwards. The cost of carry to dealers will be increased, and at current bill yields in the 3-month area the carry might be negative. Moreover, such a policy move will tend to revive market uncertainties about how far monetary restraint will go, and may make banks anxious to obtain whatever CD funds they can while they can. As more and more banks offer 5-1/2 per cent for 30-day money, the resulting upward pressures on bill rates might move the 3-month bill into a 5.20--5.40 per cent range."

Alternative B of the draft economic policy directives appeared to Mr. Clay to be satisfactory.

Mr. Wayne reported that most Fifth District business indicators continued to turn in a strong performance, roughly paralleling the national data. Both nonagricultural employment and manufacturing man-hours recorded good gains in November, and the Richmond Bank's latest survey suggested that those gains were extended in December. Respondents in the survey reported a brisk pace of retail sales through most of December, with Christmas volume running well ahead of a year earlier. The Bank's latest survey also suggested a strong demand situation in all major District manufacturing lines, and both trade sources and survey respondents noted increasingly frequent price markups. As a matter of fact, price increases appeared to be the dominant theme in the latest information on the District economy. The Bank's special survey of 21 of the leading banks on time and savings deposit flows at year end turned up no evidence of disintermediation and little in the way of apprehension among bankers that disintermediation might be imminent.

On the national scene, the financial markets appeared to Mr. Wayne to have taken the Committee's latest tightening moves in stride. Indeed, coupled with the announcement of the President's new balance of payments program, the System's latest steps had apparently contributed to a significantly improved tone in both domestic and international markets. It seemed to him, too, that the recent expressions of the U.S. determination to defend the dollar could well produce a sobering effect on business expectations and hence help to dampen the inflationary psychology that had developed in recent months.

From the standpoint of the current policy decision, Mr. Wayne said, the recent marked improvement in the tone of domestic financial markets clearly gave the Committee more room to maneuver. But he was not at all sure that it should use that extra room at this juncture. The latest improvement in the bond markets was probably due chiefly to the peace rumors, and recent history suggested that that kind of improvement could be reversed sharply and dramatically. Moreover, in the next three weeks the Committee could anticipate a number of developments that could produce important market effects. The new reserve requirements became effective, the Treasury would market a sizable bill offering, Congress would be reconvening and the surtax proposal would once again come into sharp focus, and the President would present his State of the Union and Budget Messages.

For that period, Mr. Wayne said, he would prefer to keep policy flexible and to concentrate primarily on countering any exaggerated movement in rates that might develop. He saw nothing in the latest figures and projections on credit and money expansion that suggested the need for any further restraint on reserve growth at this time. As a matter of fact, he would be eager to avoid action that might lead to negative or even zero growth in those series. For that reason, he would try to maintain about the present level of reserve availability so long as that was consistent with Federal funds rates at or slightly above the discount rate and with bill rates that varied no more than about 25 basis points from current levels, which presumably would mean a range of expectations about as outlined in the blue book. Alternative A of the draft directives seemed appropriate.

Mr. Mitchell said he thought that when the Committee heard good analysis and good advice, as it had from the staff today, it should accept them. He did not agree with some of the comments to a different effect that had been made in the go-around thus far, but would not pursue the matter. He would make only one further observation. For the first time in a long time, a reference to the money supply was included in the draft of the first paragraph of the directive, in the sentence reading, "Growth in the money supply has slackened and flows into time and savings accounts at bank and nonbank financial intermediaries have continued to moderate." If that statement did not mean that the Committee was taking a positive attitude toward the relevance of changes in the money supply, he could not conceive of any statement that would. And yet the proviso clauses of both alternatives for the second paragraph were formulated solely in terms of bank credit. He favored alternative A for the second paragraph, but would urge the Committee to refer to the money supply in that paragraph.

Mr. Maisel remarked that he would prefer alternative A of the draft directives although he felt as much concern over the directive as he had expressed at the previous meeting. He was concerned because it appeared to him that the directive reflected the fact that the Committee had not really attempted to get any basic agreement as to what goals it thought monetary policy should attempt to achieve over the next few months. He recognized that it was difficult for the Committee to agree on any specific goals; still he thought it was necessary for the Committee at least to discuss what it was attempting to accomplish. There was little indication in the directive--and, therefore, a lack of policy--with respect to the degree of impact on credit and interest rates the Committee expected or desired for the next several months.

In general, Mr. Maisel said, he was in agreement with Mr. Wayne's analysis. The reactions of the market in recent weeks seemed logical. The market's demand for liquidity had been met and, as a result, market psychology had not continued to deteriorate. The Committee should avoid action which would again cause the market to believe that still further hoarding of liquidity was desirable. It seemed clear to him that the Committee should aim at maintaining a non-inflationary flow of funds. He felt there was some danger that some members of the Committee were more concerned with maintaining the current record-breaking interest rates or forcing them higher. That seemed to him to be a poor policy. If funds were furnished at a non-inflationary rate, he would not be concerned with the interest rates set by the market.

Mr. Brimmer said he agreed with Mr. Reynold's analysis of the new balance of payments program but he would stress that much of that program was still in the projection stage. Only two elements--those relating to direct investment and to lending by financial institutions--were already in place; the others were essentially statements of what it was hoped would be put in place. The element relating to tourism was the most uncertain. While the President had appealed to U.S. citizens to avoid unnecessary travel outside the Western Hemisphere and had referred to possible legislation, he (Mr. Brimmer) had the impression from his contacts with the Administration people working in that area that the program envisaged in the President's message might be chipped away. A reduction in American tourism abroad was needed, and it was clear that much work was still to be done in that area. The measures to promote U.S. exports on which Mr. Reynolds had touched were in the negotiation stage and could not be counted on as yet.

Even though the direct investment program was in being, Mr. Brimmer continued, he was not convinced that all the desired benefits would be realized. Several countries had already indicated that they would seek exemptions from its provisions. Moreover, the new program in that area was highly complicated, and there was a great deal of uncertainty about its impact. Thus, while one might hope that it would achieve its goal, that also could not be counted on.

With respect to policy, Mr. Brimmer said he favored alternative A for the directive and would accept the description of money market conditions associated with that alternative in the blue book. He disagreed with the view some had expressed that the Committee should move toward further firming at this time. The System had used all three of its general policy instruments recently, in a coordinated manner, but now it was in a difficult period for policy making. The Federal budget was in preparation and, more importantly, Congress would again be considering the proposed income surtax. On both grounds he thought the Committee should wait before deciding on a further change in policy. There would be other opportunities for the Committee to act in the near future if events indicated that there was a need for greater monetary restraint. Moreover, the Committee should be particularly careful to avoid forcing the Board's hand with respect to Regulation Q; further firming at this time might very well reduce the available options on that Regulation, and he did not think an increase in the ceilings would be desirable at present.

Mr. Brimmer then referred to Mr. Swan's comment regarding the language relating to the reserve requirement action in alternative A of the draft directives. It was not his understanding, he said, that only an announcement effect had been sought by that action. Accordingly, he would propose adding, after the phrase in the draft reading "partly as a result of the announcement of an increase in reserve requirements," the words "effective in mid-January."

Mr. Swan remarked that a revision along the lines Mr. Brimmer had suggested would meet his objection to the original draft language.

Mr. Maisel commented that the phrase Mr. Brimmer had suggested seemed to lack clarity, and Mr. Hayes proposed language reading "partly as a result of the increase in reserve requirements announced to become effective in mid-January."

Mr. Brimmer concurred in Mr. Hayes' suggestion.

Mr. Sherrill said he thought the Committee had managed to get monetary policy in a most favorable position at a most difficult time, and accordingly he did not think the Committee should change its position. There was considerable evidence that the main thrust of existing inflationary pressures might be of a short-run nature, and that those pressures might end by the middle of 1968. Moreover, the possibility of fiscal policy action should be given some weight in the Committee's decision. In light of those considerations, he favored alternative A of the draft directives.

Mr. Hickman observed that economic activity continued to show widespread improvement through December in both the nation and the Fourth District. In the District, a smart expansion occurred in December on top of a strong showing in November. Steel output moved higher and the rate of insured unemployment declined to the lowest level since the fall of 1966. Unfortunately, prices had risen and most District manufacturers expected them to rise further, according to the Cleveland Reserve Bank's most recent monthly survey.

Apparently, Mr. Hickman said, GNP was now growing at an excessive pace, with gains in output accompanied by a general tightening of the labor market and severe pressure on prices. Price increases were absorbing unusually large portions of gains in personal income, and that seemed to be having a restraining effect on consumer demand, attitudes, and expectations. If the latest surveys of the Commerce Department and the University of Michigan proved to be correct, the contribution of consumer spending to GNP might turn out to be less than was generally anticipated, which would be desirable under present circumstances.

Mr. Hickman thought that underlying financial trends were difficult to evaluate because of year-end turbulence and recent international developments and policy actions. One thing at least was clear: the recent change in policy had been transmitted smoothly and had been accepted by financial markets and the public with minimum expectational disturbance.

It seemed to Mr. Hickman that the prudent policy now was to hold steady in the boat so that the Committee could evaluate the effects of its latest policy move. The staff projections of money and credit in January were close to the levels that he would consider appropriate as the targets for monetary policy over the next several months, although he would prefer a slightly higher growth rate for the money stock now that the growth rate of time and savings deposits had decelerated. In any event, the Committee should avoid locking in the type of showing for money and credit that had occurred in December, which would soon lead to a "credit crunch" similar to that of the second half of 1966. It was one thing to move from excessive rates of growth in money and credit to moderate and sustainable rates; it was quite another thing to have inadequate growth, or no growth at all. Moreover, in view of current international political and economic uncertainties, the President's new balance of payments program, and the hope that there might be, after all, some program of fiscal restraint, no change in policy was indicated at this time. Accordingly, he supported the staff's alternative A, with the type of modification Mr. Brimmer had proposed.

Mr. Hickman noted that in response to Mr. Holland's suggestion for a survey of time and savings deposit flows, 22 banks in the Fourth District had been contacted. The majority indicated that there had been insufficient time to take a proper reading since year-end. From the limited information available, it appeared that there were no unusual inflows or outflows of time and savings deposits around the turn of the year. Moreover, shifts among the various types of deposit appeared to have been moderate.

Mr. Daane entered the meeting at this point.

Mr. Bopp said that along with most other observers, he was impressed with the way in which the economy had shrugged off the effects of strikes in late 1967 and was moving upward with renewed vigor. At the same time, he was conscious of the continuing upward pressures on prices, as evidenced by the 0.5 per cent increase in the preliminary estimate of the wholesale price index for December.

For the Third District, Mr. Bopp remarked, only a few new readings of economic indicators had become available since the last meeting, but most of those confirmed the gathering strength. In November, construction contracts held firm. For the same month, consumer prices rose by 0.3 per cent. Unemployment rates in

December continued to edge downward throughout the major labor markets of the District.

In money and capital markets, Mr. Bopp continued, two factors had been operating recently to stabilize expectation about monetary policy. The increase in reserve requirements confirmed the move to less ease, and the President's announcement of the balance of payments program at least was an indication that monetary policy would not be so constrained by the payments deficit as many had feared.

Uncertainty about disintermediation continued, Mr. Bopp commented, although in the Third District it appeared the threat had not yet become reality. There was a $33 million drop in outstanding CD's during the first three weeks of December, but that was partially offset by an $8 million increase in other time deposits. And the decline was relatively small in light of the large amounts of CD's maturing in December. With additional large maturities in January, further declines could be expected. Nevertheless, thus far there had been no wholesale liquidations and the adjustments had been remarkably orderly.

Mr. Bopp went on to say that, in spite of decreased uncertainty about monetary policy and the beneficial effects that that had on expectations, and in spite of what seemed to be only a modest amount of disintermediation thus far, policy choices were still not easy. That was particularly so because it was much too early to assess the full impact of the policy change that had already occurred and because of uncertainty about the strength of the economy after midyear.

The Committee's move several weeks ago to slightly less ease still seemed to Mr. Bopp the appropriate choice. That, together with the increase in required reserves, should add up to only a modest move away from ease. In view of those actions, the recent sluggish behavior of the money stock and bank credit took on special significance. Both of those series, of course, were volatile and too much attention should not be paid to one month's fluctuations. Still, they bore watching to make sure that there was not an over-reaction to recent policy changes.

For the next four weeks Mr. Bopp recommended maintaining an even keel, but he would give the Desk freedom to move if money and credit aggregates seemed to be moving beyond the outside ranges of current expectations. He favored alternative A of the draft directives.

Mr. Patterson remarked that there were two main developments of note in the Sixth District. The first was the stronger performance of non-auto consumer spending and the second was a pick-up in loans, especially business loans. Generally speaking, he thought the District had recently expanded more vigorously than he had reported before.

In addition, Mr. Patterson found construction activity still showing surprisingly strong gains. While he was not sure how long that would continue, he was encouraged that District savings institutions were still gaining funds in November, although at a slower rate than before. He also got the impression from informed contacts that there was no buildup in share loans at Atlanta savings and loan associations before the year-end, and no pronounced increase in withdrawals. If that situation was representative, it seemed as if the savings and loans might have gotten by the dividend period without too much difficulty. Mortgage costs, however, had risen somewhat further. The going rate on single family mortgages for Atlanta savings and loans was 7-1/4 per cent. Private FHA quotes were nonexistent, and the market for FHA-VA loans was supported almost entirely by the Federal National Mortgage Association.

Mr. Patterson commented that inquiries of a cross-section of member banks in the District regarding savings withdrawals had produced many of the same types of answers as had already been reported in the discussion today. Several banks reported a few large transfers from CD's to Government securities. But no bank experienced severe withdrawals. In fact, generally speaking, the year-end time and savings flows were quite normal. Only one bank, which had heavily promoted a new golden passbook account, indicated it was drawing money from savings and loan associations.

Turning to policy, Mr. Patterson recalled that the last time the Committee met he had expressed a preference for waiting until things had settled down a little more, although he recognized the possibility that further tightening probably would be needed. However, as it turned out, the policy shift did not produce undesirable repercussions. He was particularly pleased that the Board saw fit to increase reserve requirements against demand deposits.

Mr. Patterson thought there was merit today in marking time and letting the markets absorb both the System's recent actions and the President's balance of payments program. As others had pointed out before, it was not a good idea for monetary policy to attempt to do too much at one time; it was better to let the effects of monetary policy work gradually into the credit picture and the financial markets. He would therefore hope that the money supply would not be permitted to decline except briefly, especially if the Regulation Q ceiling was maintained. He would prefer alternative A of the draft directives.

Mr. Francis reported that eighteen banks in the St. Louis District had been contacted to determine the extent of disintermediation of time and savings deposits around year end. None reported any serious runoffs. Bankers felt that they had lost some funds to higher-yielding competitive instruments, but the outflows in most cases were moderate. The sharpest net declines were in large CD's, and those were expected to continue contracting in January, especially if there were any further increases in market interest rates. Withdrawals of savings deposits and smaller certificates were, in most cases, more than offset by gains of new deposits. However, growth rates in those deposits had slowed markedly since October.

Mr. Francis remarked that total spending for goods and services continued to rise at a faster rate than additions to productive capacity. As a result, price increases had accelerated and they, in turn, were intensifying the country's balance of payments problem. The excessive spending reflected, in large measure, very stimulative fiscal and monetary actions of the recent past.

On the brighter side, Mr. Francis said, it appeared that progress had been made in eliminating one of the major causes of the excessive spending. Monetary actions appeared to have been less expansive in recent weeks. Since the Committee's last meeting money market conditions had tightened. Aggregate measures of monetary actions had grown less rapidly since early November, and projections for January indicated that those new trends were likely to continue.

While recognizing the desirability for immediate action in response to the sharp December gold outflow, Mr. Francis hoped that the President's new program to restrain direct investment, bank loans, and other outflows abroad would be viewed as a short-term expedient, and not as a permanent solution to the U.S. balance of payments problems. The country's problems in that area were due to excessive growth in domestic demand and to structural weaknesses in the international financial mechanism. To solve the balance of payments problems it was necessary to deal directly with those issues. In connection with the first point, the restrictive monetary policy the Committee was now following was appropriate.

Mr. Francis thought that the change in reserve requirements had provided a desirable announcement to the world that a move was being made toward monetary restraint. That action should now be accompanied by further restraint in open market policy to avoid having the effects of the higher requirements offset by net System purchases of securities. However, in view of the recent slowing in the growth rate of reserves, bank credit, and money, care must be taken to avoid overreacting.

As to current policy, Mr. Francis felt that monetary developments of recent weeks had been in the desired direction and that they should be continued. Over the next few months, he would like to see the monetary aggregates rise, but only moderately. With that objective in mind, money market conditions should be permitted to firm slightly. While he would not find it difficult to accept alternative A for the directive, he would prefer alternative B.

Mr. Daane said that since he had not had the benefit of hearing the full go-around today he would not comment at length on policy. He could accept either alternative for the directive. Under current circumstances, however, he would be inclined to maintain the firmer money market conditions that had been established, as called for by alternative A.

Mr. Daane then noted that earlier today he had attended a meeting at which there had been a fairly full review of the reports by the teams that had been sent to Europe and to the Far East to explain the President's balance of payments program. From the remarks at the meeting of Under Secretaries Rostow and Deming, it appeared that in general the program had met with a considerable degree of approval, at least in principle. The approval was rather grudging in some cases, with some of the same concerns expressed over particular aspects that he gathered Mr. Coombs had heard at the weekend meeting in Basle. One concern was about the possible deflationary impact of the direct investment cuts, particularly in Belgium where investment by American firms accounted for a high percentage of total investment. There also were some fears that the program with respect to trade might trigger retaliatory actions and set off a wave of protectionism. The observation had been made to the team visiting the Far East that it would be much better for other countries to reduce their barriers to trade than for the

United States to increase its barriers. Concern was also expressed as to whether the U.S. would take the necessary steps to restrain demand, including fiscal action, that were required to make the program work and to prevent the entire burden falling on Europe.

Mr. Daane remarked that two sidelights might be of interest to the Committee. First, Mr. Deming had drawn a distinction between the reactions in Europe of central banks and governments. The program was much more acceptable, both in general and in terms of specific elements, to the central banks; political considerations relating to some aspects led to more grudging acceptance by governments. Secondly, with one exception, the subject of Vietnam was not mentioned to the teams. But in most of the countries visited the need for early action to remove the gold cover on U.S. currency was mentioned, and some surprise was expressed that that had not already been done.

Mr. Robertson made the following statement:

> In our policy discussion today, I think we have to be careful to distinguish which key elements have changed significantly since we last met, and which have not.
>
> I take it that our business advance is proceeding on about the same high track as was projected at the last meeting. That represents an inflationary pace, and it needs to be curbed somewhat.
>
> On the balance of payments front, the Administration's new program has reversed the psychological slide of the dollar in the international exchange markets; and the tighter rules on capital flows should cut our 1968 deficit sharply. But over the long run, the fundamental

need of the United States is for a vigorous and sustainable enlargement of our current account surplus, and that is a slow, tough task to accomplish, both through international negotiations and through the workings of appropriate relative adjustments in domestic demand, productivity, and prices.

On the financial front, I think we have managed to achieve some significant change. The combination of slightly more restrictive open market operations and the increase in reserve requirements has made abundantly clear to all concerned that monetary policy has turned toward restraint. Actually, money market conditions themselves are only modestly tighter, and in some long-term markets interest rates are lower than in early December, thanks in good part to psychological reactions to a succession of stories regarded as bullish for bonds. But the rates of growth of bank credit and the money supply have slackened still more, and reports suggest a substantial slowdown also in the flows of funds through nonbank intermediaries. Perhaps equally important, there is a sense of more cautious lending policies spreading through the financial system, undoubtedly a combined result of tightened reserve availability, reduced savings inflows, and a feeling of proximity to interest rate and other regulatory thresholds that could cut substantially into lending capacity.

All this, it seems to me, is about what we should have been hoping for in response to our careful firming of policy. The results strike me as appropriate, and I would like to see us continue in this same vein. By that I mean to imply capturing and holding all the firmness that has recently been injected into bank reserve positions and related money market conditions, while not taking any overt steps toward further tightening. I would assume that such a "no further change" operating guide might well need to include a slightly shallower free reserve figure after the effective dates of the reserve requirement increase, since something of this order has probably been discounted by banks and market participants, and failure for it to occur might lead to some relaxation of the present degree of pressure. But I am not thinking of any greater firming than could be accommodated within the range of money market conditions specified in the blue book as consistent with alternative A of the draft directives. Accordingly, I would vote in favor of that language as an instruction to the Manager

> until the next meeting, with the two-way bank credit proviso to guard against any surprisingly largerthan expected movements in the course of the financial aggregates.

Chairman Martin said he thought that monetary policy was in a better position at present than had seemed likely near the end of last year. He did not favor an overt move toward further firming at this juncture. Such a move, even if it were moderate, would carry implications for the tenability of present Regulation Q ceilings, and he would not want to have the question of a possible increase in those ceilings raised at this time. Accordingly, he had a clear preference for alternative A for the second paragraph of the directive.

It appeared from the go-around, Chairman Martin continued, that the Committee as a whole also favored alternative A. A few members had expressed views on policy that differed in some respects from those of others, but the differences seemed to be relatively minor and largely matters of interpretation.

The Chairman then suggested that the Committee vote on a directive which included alternative A for the second paragraph, with the change in the reference to the reserve requirement increase suggested by Mr. Brimmer, as modified by Mr. Hayes. As to the first paragraph, the problem Mr. Swan had noted in the opening sentence of the staff's draft might be dealt with by referring to "persisting inflationary pressures in the period ahead."

Messrs. Swan and Francis commented that such a directive would be acceptable to them.

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

> The information reviewed at this meeting indicates that over-all economic activity has been expanding vigorously, with both industrial and consumer prices continuing to rise at a substantial rate, and that prospects are for further rapid growth and persisting inflationary pressures in the period ahead. The imbalance in U.S. international transactions worsened further in late 1967, but the new program announced by the President should result in a considerable reduction in the deficit this year. Following announcement of the program, foreign purchases of gold slackened abruptly and the dollar strengthened in foreign exchange markets. Long-term bond yields have declined in recent weeks but some short-term interest rates have risen further. Bank credit has changed little on balance recently as banks have disposed of Government securities to accommodate strengthened loan demands. Growth in the money supply has slackened and flows into time and savings accounts at bank and nonbank financial intermediaries have continued to moderate. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resistance of inflationary pressures and progress toward reasonable equilibrium in the country's balance of payments.

> To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the somewhat firmer conditions that have developed in the money market in recent weeks, partly as a result of the increase in reserve requirements announced to become effective in mid-January; provided, however,

> that operations shall be modified as needed to moderate 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, February 6, 1968, at 9:30 a.m. Chairman Martin noted that under present plans the staff's economic and financial reports at that meeting would take the form of a chart presentation. The President's State of the Union and Budget Messages would have been presented to Congress by that time, and the Committee would have the opportunity to undertake a full-scale review of the economic situation and outlook. Accordingly, in making their transportation plans, those attending the meeting should allow for the possibility that it would continue into the afternoon.

The Chairman then noted that a memorandum from the Secretariat, entitled "Procedures with respect to oaths of office of incoming Committee members", had been distributed to the Committee under date of January 4, 1968.[1/] He invited Mr. Holland to comment.

Mr. Holland observed that the memorandum had been prepared in light of the Committee's discussion at its meeting on November 14, 1967, of its meeting schedules and related matters. The memorandum suggested a change in the customary procedure under which incoming Committee members and alternates from the Reserve Banks took their

[1/] A copy of this memorandum has been placed in the files of the Committee.

oaths of office in Washington at the time of the organization meeting in March. Specifically, it suggested that the new members and alternates take their oaths in their own Districts promptly following the certification of their election and have the executed oaths mailed to the Secretary as soon as practicable. The proposed procedure appeared to be workable and the Committee's General Counsel had found no legal objection to it. It would have the advantage of permitting incoming, rather than outgoing, members to act on any matters of policy that arose in early March before the time of the organization meeting, and it would remove one of the constraints on the date at which that meeting was scheduled.

It was agreed that the procedures suggested in the memorandum with respect to oaths of office of incoming Committee members and alternates should be followed in the future.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

January 8, 1968

Drafts of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on January 9, 1968

FIRST PARAGRAPH

The information reviewed at this meeting indicates that over-all economic activity has been expanding vigorously, with both industrial and consumer prices continuing to rise at a substantial rate, and that prospects are for further rapid growth and persisting inflationary pressures in the months ahead. The imbalance in U.S. international transactions worsened further in late 1967, but the new program announced by the President should result in a considerable reduction in the deficit this year. Following announcement of the program, foreign purchases of gold slackened abruptly and the dollar strengthened in foreign exchange markets. Long-term bond yields have declined in recent weeks but some short-term interest rates have risen further. Bank credit has changed little on balance recently as banks have disposed of Government securities to accommodate strengthened loan demands. Growth in the money supply has slackened and flows into time and savings accounts at bank and nonbank financial intermediaries have continued to moderate. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resistance of inflationary pressures and progress toward reasonable equilibrium in the country's balance of payments.

SECOND PARAGRAPH

Alternative A

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the somewhat firmer conditions that have developed in the money market in recent weeks, partly as a result of the announcement of an increase in reserve requirements; provided, however, that operations shall be modified as needed to moderate any apparently significant deviations of bank credit from current expectations.

Alternative B

To implement this policy against the background of the recently announced increase in reserve requirements, System open market operations until the next meeting of the Committee shall be conducted with a view to achieving slightly firmer conditions in the money market, unless bank credit appears to be expanding significantly less than currently expected or any unusual liquidity pressures develop.