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, July 16, 1968, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Brimmer
Mr. Daane
Mr. Galusha
Mr. Hickman
Mr. Kimbrel
Mr. Maisel
Mr. Mitchell
Mr. Robertson
Mr. Sherrill
Mr. Bopp, Alternate1/

Messrs. Clay, Coldwell, and Scanlon, Alternate Members of the Federal Open Market Committee

Messrs. Francis and Swan, Presidents of the Federal Reserve Banks of St. Louis and San Francisco, respectively

Mr. Holland, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Molony, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Brill, Economist
Messrs. Axilrod, Hersey, Kareken,1/ Mann, Partee, and Reynolds, Associate Economists
Mr. Holmes, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

1/ Entered the meeting at the point indicated.

Mr. Cardon, Assistant to the Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Wernick, Associate Adviser, Division of Research and Statistics, Board of Governors
Mr. Bernard, Special Assistant, Office of the Secretary, Board of Governors
Mr. Baker, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, Open Market Secretariat Assistant, Office of the Secretary, Board of Governors

Messrs. Latham and Black, First Vice Presidents of the Federal Reserve Banks of Boston and Richmond, respectively
Messrs. Eastburn, Parthemos, Brandt, Baughman, Jones, Tow, Green, and Craven, Vice Presidents of the Federal Reserve Banks of Philadelphia, Richmond, Atlanta, Chicago, St. Louis, Kansas City, Dallas, and San Francisco, respectively
Mr. Garvy, Economic Adviser, Federal Reserve Bank of New York
Mr. Cooper, Manager, Securities and Acceptance Departments, Federal Reserve Bank of New York
Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on June 18, 1968, were approved.

The memorandum of discussion for the meeting of the Federal Open Market Committee held on June 18, 1968, was accepted.

By unanimous vote, the action taken by Committee members on July 2,

1968, approving an increase, effective immediately, in the reciprocal currency arrangement with the Bank of France from $100 million to $700 million, and the corresponding amendment to paragraph 2 of the authorization for System foreign currency operations, was ratified.

Mr. Holland reported that Mr. Kareken, who had been an Associate Economist of the Committee from the Federal Reserve Bank of Minneapolis, had been separated from the System for a period of about two weeks in the interim since the last meeting of the Committee. However, he was now back in the employ of the Minneapolis Bank and that Bank was again nominating him to the position of Associate Economist.

By unanimous vote, John H. Kareken was elected Associate Economist of the Committee to serve until the first meeting of Committee after February 28, 1969, with the understanding that in the event of the discontinuance of his official connection with the Federal Reserve Bank of Minneapolis, he would cease to have any official connection with the Federal Open Market Committee.

Mr. Kareken entered the meeting at this point.

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 June 18 through July 10, 1968, and a supplemental report covering the period July 11 through 15, 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 again this week. The Stabilization Fund, as of the close of business yesterday, had $288 million of gold on hand against which there were prospective orders of $48 million. On the other hand, the Bank of France was selling another $75 million of gold to the Treasury today, so the Fund should remain for a while in the most comfortable position it had experienced in a good many years.

Turnover on the London gold market had been on a declining trend over the last month or so, Mr. Coombs observed. Price quotations had held remarkably steady around the $41 mark until early last week when press rumors of a deal designed to encourage sales of South African gold in the market brought about a sharp decline in the price. The announcement last Wednesday afternoon (July 10) of new credit lines for the Bank of France brought a further price decline, to a level of roughly $39. Today the price had dipped to slightly below $39.

On the exchange markets, Mr. Coombs continued, the French franc had remained subject to very heavy pressure. The total

drain of French reserves since the crisis began now exceeded $2 billion. The Bank of France's proposal for an increase in its swap line with the System, together with supporting credits from the Common Market central banks, was apparently inspired by apprehension that publication in early July of the June reserve loss of more than $1 billion would incite further speculation. However, the Bank of France was unable to get from its Common Market partners the same immediate action which the System had provided, and it was not until a meeting of the Common Market central bank governors at Basle last Monday (July 8) that agreement for their participation was finally reached. Last Wednesday the Bank of France made an urgent request for immediate announcement of the whole package, partly in order to take the edge off the report due the next day showing that the French had lost $400 million of reserves during the week ended July 4.

Announcement of the credit package immediately lifted the French franc off the floor and also brought down the French gold price, Mr. Coombs said. However, that initially favorable effect was immediately washed out when the $400 million reserve loss was published. Last Friday the Bank of France lost an additional $65 million, but it did not experience any losses in New York yesterday when the Paris market was closed for the holiday. Today the French franc was just barely off the floor and there did not appear to

have been any further losses. The dollar balances of the Bank of France had now been reduced to relatively low levels, and he thought it fairly likely that the French might have to draw on their new swap lines in the near future, including a possibly sizable drawing on the System.

In the case of sterling, Mr. Coombs remarked, British reserve drains of $360 million during June were followed in early July by further sizable losses which required new British drawings of $500 million on the Federal Reserve swap line. Last week, however, the announcement of a new credit package to underwrite the sterling balances, together with improved trade figures for June, had relieved market fears of an imminent breakdown and had led to moderate short-covering. Sterling also seemed to have benefited from last week's announcement of new credit facilities to defend the French franc and from press reports of a new marketing arrangement with South Africa which might depress the free market price of gold in London. As the Committee knew, sterling had been highly sensitive to developments in both the French franc and gold markets and had accordingly strengthened as market worries in those two areas had subsided somewhat. Since last Thursday the Bank of England had taken in about $120 million, and tomorrow would use $100 of those reserve gains to pay down its swap debt to the Federal Reserve to $400 million. There had thus

occurred during the past week an unusual concentration of good news which had noticeably lifted sentiment in the market. While welcoming those favorable developments, the market was inclined to regard them as providing no more than a breathing space in a highly vulnerable situation. The market remained very much in a wait-and-see mood. Yesterday and today there were indications that earlier short-covering of sterling was showing signs of fading.

At the latest meeting of the Bank for International Settlements, Mr. Coombs observed, he had completed negotiations with the Swiss National Bank for complete liquidation of the System's $135 million Swiss franc debt to that Bank. That was accomplished by the issuance today by the U.S. Treasury of Swiss franc Treasury bills to the Swiss National Bank. That transaction completely paid off the last remaining debt of the Federal Reserve System under the swap lines; such debt had reached a peak of $1.8 billion last December. At the same time there were outstanding Federal Reserve credits of $942 million to seven different foreign banks in the network. In the light of experience since the inception of the swap network, that was a highly unusual situation. The System had generally found itself in the position in which its lending and borrowing operations tended to parallel one another; for example, at times when the British had drawn on the Federal

Reserve facility, the System typically had to mop up the dollars flowing from London to the central banks of other countries. This time, the British and French drawings on the International Monetary Fund had enabled the System to pay off a considerable amount of Federal Reserve debt generated by earlier speculative attacks on sterling. Equally important, continuing heavy outflows from both London and Paris, together with dollar outflows resulting from the U.S. deficit, had been very largely absorbed by the Euro-dollar market as well as by foreign placements in the U.S. stock market and overseas U.S. issues of convertible bonds. Obviously, some of the helpful factors could not be expected to continue.

Mr. Coombs thought the fact that several central banks recently had drawn on their swap lines with the System for the first time had been a highly useful development. The result had been an increased appreciation on the part of the System's partners of the usefulness of the swap network to them, which should put an end to the feeling that it represented a one-way street. The increase in the French swap line had been particularly helpful, since the earlier reluctance of the French to expand their line had seemed to leave a gap in the central bank defenses against speculation. Hopefully, the network now was on a more solid footing.

Mr. Mitchell asked how the Committee might protect itself in the event the French, like the British, were to court disaster

by overextending themselves in the use of international credit facilities.

Mr. Coombs expressed the view that the French were unlikely to resort to international credit assistance to the extent the British had. He also thought the French situation represented a lesser risk because there did not exist a large volume of foreign-held French francs and because the French would probably be willing to let the parity go much sooner than had their British counterparts. There was no doubt in his mind that the Bank of France would pay off its indebtedness by the due date. The present French Government would insist upon prompt repayment, and would borrow from the Fund if necessary.

In reply to another question by Mr. Mitchell, Mr. Coombs said he did not know how soon the French situation would be clarified. Indeed, he did not think anyone, including the French, could supply the answer. Comments at the recent meeting in Basle reflected that uncertainty. There continued to be a day-to-day threat to the French franc, and if the franc failed to weather the storm there would be serious consequences for sterling.

Mr. Mitchell then inquired about the attitude of Western European countries toward enlargement of their credit facilities for France.

In reply, Mr. Coombs noted that under the Common Market bureaucracy credit requests from member countries were subjected to full multilateral scrutiny by various joint committees. The Committee might recall that when Italy had applied directly to the United States for credit assistance in 1964, their partners had made a major issue of the episode. On the present occasion, when the French had tried to press for quick action, the other countries had insisted that they proceed in an orderly way through all the committees of the Common Market bureaucracy.

In reply to another question by Mr. Mitchell, Mr. Coombs said he assumed that the French would make any drawings in a pro-rata fashion, using their credit facilities with various central banks. There was no question but that their European lines were fully available to them, although drawings might create problems for certain European central banks that currently were short of dollars as a result of recent developments. However, he did not think such shortages would last very long.

Mr. Hickman asked whether the French were made to understand in the recent negotiations that their swap facility with the System was a two-way street.

Mr. Coombs said he would assume that, in contrast to their earlier attitude, the French now felt a moral obligation to honor the reciprocal nature of the swap facility. Particularly in light

of the world-wide publicity given the recent credit arrangements for France, he did not think they would hold back if the Federal Reserve wished to draw on the swap line at some future time.

> By unanimous vote, the System open market transactions in foreign currencies during the period June 18 through July 15, 1968, were approved, ratified, and confirmed.

Mr. Coombs then noted that $125 million of the Bank of Canada's drawing on its swap line with the System was still outstanding and would mature July 30, 1968. The Bank of Canada intended to pay off that indebtedness by the due date. To cover the contingency that they would not be able to, however, he would recommend renewal of the drawing if necessary. That would be a second renewal.

> Renewal of the drawing by the Bank of Canada was noted without objection.

Mr. Coombs reported that the System had a total of $15 million equivalent of Swiss franc forward commitments maturing August 19-20. Those forwards had been on the books since March and originally had had varying maturities. He thought it would be possible to pay them off before their next maturity dates, but in the event that was not feasible, he would recommend their renewal.

> Renewal of the System's forward commitments in Swiss francs was noted without objection.

Mr. Bopp entered the meeting at this point.

Chairman Martin then noted that a document dated July 2, 1968, and entitled "Proposal for U.S. Participation in Sterling Balances Credit Package"[1/] had been distributed to the Committee with Mr. Holland's memorandum of July 15, 1968.[2/] The Chairman

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1/ Appended to this memorandum as Attachment A.

2/ Also enclosed with Mr. Holland's memorandum, which was entitled "Federal Reserve participation in proposed funding arrangement for sterling balances," were copies of a draft plan for funding sterling balances, dated May 31, 1968, and entitled "A Possible Second Group Arrangement," that had been distributed at the June 1968 meeting of the Bank for International Settlements; and a letter dated June 21, 1968, addressed by the Bank of England to the principal institutions participating in the June discussions at the BIS, outlining British plans for dealing with sterling balances in greater detail. Earlier, on July 2, 1968, there had been distributed to the Committee a memorandum from Mr. Hackley dated July 1, 1968, analyzing affirmatively the legality of a possible procedure for Federal Reserve participation in the proposed funding arrangement. Copies of these various documents have been placed in the files of the Committee.

In his memorandum Mr. Holland noted, among other things, that (1) on July 1, 1968, at the request of Chairman Martin, he had contacted each available member of the Committee to determine if they were agreeable to negotiation of Federal Reserve participation in a sterling balance funding arrangement along the lines contemplated, and that all available members had responded affirmatively; (2) the details of such System participation were set down in final form in the document of understanding (shown here as Attachment A) and agreed to by the Treasury Department; (3) the U.S. Government had agreed to enter into international negotiations of the proposed sterling balance funding arrangement on the basis that the United States would provide up to $600 million (or $700 million if France were unable to participate) of the proposed $2 billion package of credit assistance; (4) at meetings on July 6-8, 1968, in connection with the monthly meeting of the BIS, agreement was reached in principle among participating central banks and the BIS on the sterling balance funding arrangement as proposed; and (5) British representatives were now engaged in negotiations with all major sterling area countries to obtain their assent to the arrangement as outlined.

observed that Mr. Robertson had been the chief U.S. representative at the meetings of July 6-8, where funding arrangements for sterling balances had been discussed, and invited him to comment.

Mr. Robertson said his remarks could be brief in view of the documentation that had been provided to the Committee. He recommended that the Committee give its formal approval today to the proposal for temporary System warehousing of sterling acquired by the Treasury in connection with the sterling balances credit package. The proposal, as outlined in the document of understanding referred to earlier by Chairman Martin, made it clear that the Treasury would act as principal and would assume the primary obligation in the funding arrangement. The Federal Reserve would, however, undertake a commitment to support the Treasury. If the Committee decided to approve the proposal, the Treasury would be asked for a definite confirmation of the understanding.

Mr. Daane commented that the proposal seemed reasonable to him.

Mr. Holland noted that Committee approval of Mr. Robertson' recommendation would necessitate an amendment to paragraph 1C(1) of the authorization for System foreign currency operations. Specifically, the $350 million limit on System commitments to deliver foreign currencies to the Stabilization Fund specified in that paragraph would have to be raised by an appropriate

amount, not to exceed $700 million. He suggested that the Committee consider an action increasing that limit to a figure not exceeding $1,050 million, with the specific figure to be determined by Chairman Martin (or, in his absence, Mr. Robertson) in light of the nature of the participation of other countries in the arrangement, subject to the understanding that the action would become effective upon a determination by Chairman Martin (or Mr. Robertson) that it was in the national interest.

> By unanimous vote, paragraph 1C(1) of the authorization for System foreign currency operations was amended to increase the limit on outstanding System forward commitments to deliver foreign currencies to the Stabilization Fund from $350 million to a level to be determined by Chairman Martin (or, in his absence, Mr. Robertson) in light of the participation of other countries in the proposed funding arrangement for sterling balances but not exceeding $1,050 million equivalent, subject to the understanding that the action would become effective upon a determination by Chairman Martin (or, in his absence, Mr. Robertson) that it was in the national interest.

Chairman Martin observed that a revised draft of a letter[1/] from the Secretary of the Treasury to him concerning Treasury backstop facilities for Federal Reserve swap arrangements had been distributed to the Committee on July 15, 1968. The draft, which was a revision of an earlier draft sent to the Committee on

1/ Appended to this memorandum as Attachment B.

June 25, had been prepared in the course of a meeting between Treasury and Federal Open Market Committee officials. The final letter had not yet been signed by Secretary Fowler, but the draft appeared to him (Chairman Martin) to be in acceptable form.

In the discussion that followed it was noted that it was not planned to make the final letter public.

> Secretary's Note: The letter in question, in the form shown in Attachment B, was signed by Secretary Fowler under date of July 23, 1968, and subsequently delivered to Chairman Martin.

Mr. Robertson then reported on discussions in which he had participated at the recent Basle meetings concerning South African gold. He noted that the discussions had been lengthy and at times heated. Many central banks wanted to acquire gold from South Africa to increase their monetary stocks and there was a general desire to get South Africa to sell gold in the private market. He had reminded the group that in the United States the Treasury had the final responsibility for gold policy and had specified the limits of his authority. While no formal agreements could be made within the limits of his authority, an understanding was reached that conversations would be held with South Africa with a view to encouraging that country to sell gold in the private market. Such sales of South African gold were deemed to be advantageous in bringing down the market price of gold closer to $35 per ounce and in making the official price of $35 per ounce more viable. In

addition, the substantial danger that central banks would deviate from the March 17 understandings and purchase gold directly from South Africa would be lessened thereby.

Mr. Robertson observed that in return for agreeing to sell its gold into the market in an orderly way and withdrawing any application to sell gold to the International Monetary Fund, it was proposed that South Africa should be assured of a $35 floor on the price of its gold. Such a floor might be set through the mechanism of the Fund. It would be expected that South Africa would not offer gold to the Fund until the market price was below $35, and that it would refrain from offering gold from its monetary reserves until all newly-mined gold had been sold in the market. Furthermore, South Africa would be expected to refrain from offering newly-mined gold to central banks. It would be allowed to consider as part of its monetary reserves all gold added thereto between March 17 and July 1.

Upon his return, Mr. Robertson continued, Chairman Martin and he had reviewed the Basle understandings with Treasury officials. It had been arranged that Chairman Martin would endeavor to discuss the matter with the Governor of the South African Reserve Bank and report back to the Secretary.

Mr. Brimmer commented that he did not clearly understand the U.S. position with respect to a floor for the private market price of gold.

Mr. Robertson remarked that erroneous newspaper accounts had given rise to misconceptions on the subject. The position which he had urged in Basle, and later to the Secretary of the Treasury and other Treasury officials, contemplated that when the free market price of gold fell below $35 the United States and other countries represented at the meeting would support acquisitions by the Fund at $35 less handling charges. That was the basis on which the Chairman was now authorized to negotiate with the South Africans. In his view, it simply was not feasible for the market price to fall far below $35.

Mr. Daane noted that any leakage regarding the understandings on which Mr. Robertson had reported would have unfortunate consequences. In particular, the United States should not disclose its position on the matter prior to the Chairman's discussion with the South Africans.

Chairman Martin concurred in Mr. Daane's statement. He added that he had not seen any indication in the press that he was going to meet with the South Africans, and thought it would be most unfortunate if that fact became known.

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 June 18 through July 10, 1968, and a supplemental

report covering July 11 through 15, 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:

> The period since the Committee last met was highlighted by the final passage of the tax surcharge and spending cut bill and by growing expectations of a relaxation of monetary policy. The timing and extent of any such relaxation has been a matter of prime concern and debate among market participants with a fair degree of caution developing in recent days. The period also saw complications arising out of the June tax period, the mid-year statement date for commercial banks and interest-crediting period for thrift institutions, the auction of $4 billion tax bills by the Treasury, the 4th of July holiday, and a very heavy volume of foreign operations affecting bank reserve positions and the Treasury's cash position.
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> Implementation of the directive adopted by the Committee at its last meeting created a feeling in the market that the System had taken the edge off the tightness that had prevailed in the money market; the reduction in the repurchase agreement rate to 5-5/8 per cent on July 5 was generally interpreted as meaning that the System was favorably disposed to the lower level of interest rates that had developed. In the circumstances, with the market keeping a particularly close watch on the System, there was some danger that changing the RP rate would be given an overdramatic interpretation and this was the main factor behind the modest 1/8 per cent move.
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> The decline in interest rates was especially pronounced in the Government securities market--where, as the green book[1/] notes, rates are now 30 to 80 basis points below their May highs. The rate on three-month Treasury bills fell to as low as 5.20 per cent early in the period under the influence of a broad-based private

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

demand and heavy System buying. When temporary demand factors had passed, the rate bounced back to fluctuate narrowly around 5-3/8 per cent, the lower end of the range considered desirable by the Committee at the time of the last meeting. The spread between three-month and longer-term bill rates was quite narrow, reflecting expectations of further declines in interest rate levels. The yield curve stayed flat despite the Treasury's auction of $4 billion March and April tax bills. Banks bid aggressively for the bills and dealers subsequently proved to be willing holders. There was some backup of rates in yesterday's regular Treasury bill auction. Average rates of 5.47 and 5.55 per cent were set for three- and six-month bills respectively, down 12 and 8 basis points from the auction just preceding the last Committee meeting. I should note that in yesterday's auction, we planned to redeem $100 million maturing bills, but we entered our bids at rates close to the expected stop-out. In the event, our marginal bid for $50 million 90-day bills received a partial award of $35 million.

The general decline in interest rates greatly eased the problem of the thrift institutions over their interest-crediting period, and fears of disintermediation proved to be unfounded. The decline in Treasury bill rates made CD's more competitive. CD losses turned out to be less than seasonal, and by the close of the period rates on longer maturities--six months or more--had edged away from the Regulation Q ceilings. The better CD performance helped raise the credit proxy to 6 per cent in June--the upper limit of the range projected at the last meeting. In addition, large U.S. banks added substantially to their Euro-dollar holdings as reserve losses by Britain and France seemed to be flowing into the Euro-dollar market rather than into other central bank reserve holdings. It perhaps bears noting that the formal credit proxy projections presented in the blue book[1] do not include Euro-dollar holdings--mainly because of the lack of any firm basis for projecting the future. There is usually, however, some independent guess as to prospective changes in that factor. As the situation unfolds and the data become available we have

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

generally followed the practice of folding changes in Euro-dollar holdings into the proxy in determining whether current Committee expectations are being met. For July, for example, the credit proxy proper is projected to grow at 2 per cent, but anticipated changes in Euro-dollars would raise the total to 4 per cent, which would appear to be the more relevant figure.

To return to interest rate developments, yields on intermediate- and long-term Governments declined significantly; the 7-year 6 per cent note offered in the May refunding traded to yield 5.73 per cent at the close last night--down 18 basis points from the time of the last meeting and down nearly 1/2 per cent from the peak yield in May. Despite some profit taking, dealers appeared to be willing to maintain inventories in expectation of capital gains but did not appear to be overdoing it.

In the private capital markets interest rate movements were less pronounced, reflecting the sizable calendar of corporate and municipal issues in both June and July. In the corporate market attention focused on the $250 million Jersey Standard offering on July 11. Prior to that offering, syndicate terminations had resulted in somewhat higher corporate yields, as investors played a wait-and-see game. The quick sell-out of the Jersey issue--which moved to a premium large enough to reduce the yield from 6.50 per cent to 6.40 per cent--created a far more optimistic attitude. This optimism spread into the municipal market as well, with the Bond Buyer index declining by 12 basis points in the week ending July 11 and with dealer inventories declining after a buildup in late June. Prospective interest rate developments in these markets appear to rest heavily on what happens to the August calendar--particularly in the corporate market.

Open market operations have been amply described in the written reports and require little further comment here. On balance, domestic open market operations supplied over $1 billion to the market during the interval, although we have turned to reserve absorption in the current statement week. The reserve numbers and associated money market variables have fluctuated rather widely over the period, reflecting the many special factors involved. In particular, the

low net borrowed reserve figure published for the statement week just passed, which, incidentally, will be revised to net free reserves, was not accompanied by a corresponding easing in the money market, and, in view of similar patterns for that week in prior years, does not appear to have been seized on by the market as confirmation of a pronounced shift in System policy. Borrowing from the Reserve Banks has been on the low side recently, raising some questions about the consistency of a 6 per cent Federal funds rate and a level of borrowing of $600 million or more.

The massive impact of the foreign operations, reported by Mr. Coombs, on bank reserve positions should be specially noted. The British swap repayment and associated transactions on June 19 absorbed $3/4 billion in reserves, as anticipated, and required offsetting operations in the market. The expected need to supply additional reserves through domestic operations was subsequently sharply reduced by foreign drawings on the swap lines that provided $600 million in reserves over the balance of the period. So far we have been able, fortunately, to accommodate these reserve swings without perverse market effects, but we may not always be so lucky. It is obvious that close coordination between foreign and domestic operations will continuously be necessary in light of the expected agreement on sterling balances and the likelihood of other large foreign transactions.

Not only domestic open market operations are involved. The management of the Treasury's cash position has been considerably complicated by gains and drains associated with foreign operations. While, as the written reports indicate, the Treasury's average cash balance was higher than expected in June as the result of foreign transactions, there was a drain of nearly $1 billion after June 18, resulting in heavier calls on C bank balances than had been expected earlier.

The passage of the tax bill has, of course, made the problem of Treasury financing a far more manageable proposition and the generally confident market atmosphere augurs well for the forthcoming refunding of $8.6 billion August maturities, of which $3.7 billion are held by the public. While current estimates are subject to revision, it looks like the Treasury will need to raise $3 billion

or more in new money by the end of August. To raise part of this cash an early announcement by the Federal National Mortgage Association of the sale of $1.3 billion in participation certificates, of which $800 million would be offered to the public, is a distinct possibility. This would exhaust the current PC authority for FNMA and so far as I know no new legislation is in the works. The additional cash needed could well be raised in conjunction with the August refunding to be announced on July 31, although the Treasury has not firmed up its plans as yet. It is entirely possible that a combined exchange-cash offering will turn out to be appropriate, with an intermediate note being offered for exchange and a short note for cash. If an optional offering is made by the Treasury, and if the Committee approves the procedures for System subscriptions contained in my memorandum of July 10,1/ I would propose to split the System's subscription of $4.8 billion, representing our holdings of maturing issues, between the new issues in rough proportion to the expected public subscription. If the Treasury does decide to raise cash in conjunction with the August refunding, it should be out of the market until late October or early November.

Mr. Mitchell remarked that market developments over the last two or three weeks had been interpreted by a number of financial writers as suggesting that monetary policy had started to move toward ease. He wondered if such press stories had hampered the Desk's operations and whether expectations were now playing a major role in the market.

Mr. Holmes replied that the actual passage of the tax bill and the belief that such passage would take pressure off monetary

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1/ The memorandum, entitled "System Subscriptions in Treasury Cash Refundings," is a revised and abbreviated version of an earlier memorandum distributed to the Committee on June 6, 1968. Copies of both memoranda have been placed in the files of the Committee.

policy had contributed to the decline in Treasury bill rates following the last meeting of the Committee. In line with staff expectations at that meeting, bill rates subsequently turned up and erased part of the decline. As he had understood the Committee's intent at the last meeting, bill rates were to be allowed to decline and the Desk was not expected to take measures to move them back up. Accordingly, when the decline materialized the Desk had adjusted its operations and had not allowed the money market to get too tight. A 6 per cent Federal funds rate, however, had not proved consistent with the levels of member bank borrowings and net borrowed reserves expected at the last meeting. Borrowings and net borrowed reserves had declined more than anticipated, although the figures for the latest week represented a seasonal aberration. Market expectations had played an important role during part of the recent period, but more recently markets appeared to have settled down.

In reply to a question by Mr. Swan, Mr. Holmes said he had no good explanation for the recent change in the relation between the Federal funds rate and other money market variables. Banks had reduced their borrowings from the System, and, apparently, a return to the $600 million level of borrowings--given the state of expectations--would require a very tight money market, including Federal funds trading around 6-3/8 per cent.

Mr. Brimmer asked Mr. Holmes if he thought the small reduction--from 5-3/4 to 5-5/8 per cent--in the rate on System repurchase agreements had had any impact on the money market.

Mr. Holmes thought the reduction might have had some influence on the market, but the fact that the Desk had been fairly liberal in providing reserves had perhaps contributed more to the market view that the edge of tightness was off current monetary policy.

> By unanimous vote, the open market transactions in Government securities, agency obligations, and bankers' acceptances during the period June 18 through July 15, 1968, were approved, ratified, and confirmed.

Chairman Martin recalled that at its June 18 meeting the Committee had authorized the Manager to discuss with Treasury officials certain proposals for System subscriptions in Treasury cash refundings. He asked Mr. Holmes to report on his conversation with the Treasury.

Mr. Holmes noted that a tentative agreement, subject to Committee approval, had been worked out with the Treasury on System subscription procedures in Treasury cash refundings on the basis of his memorandum dated July 10, 1968, to which he had referred in his statement. Treasury officials had expressed a desire to review further their procedures with respect to the "bedfellows," and if

they had any modifications to suggest, they would consult with the Committee and would make no changes without receiving prior Committee approval. The Treasury officials had indicated that they might wish to make public some background material when the new procedures were implemented, and it was felt that the present version of his memorandum would be suitable for that purpose.

> By unanimous vote, new procedures for System subscriptions in Treasury cash refundings, as proposed in the Manager's memorandum of July 10, 1968, were approved.

It was agreed that a letter should be sent to the Secretary of the Treasury concerning the new procedures.

> Secretary's Note: On July 18, 1968, the following letter was sent to the Secretary of the Treasury over the Chairman's signature:

I am enclosing a memorandum prepared by the Manager of the System Open Market Account regarding the handling of System subscriptions to Treasury refunding offerings in the light of recent innovations in Treasury debt management techniques.

These innovations--which involved combining an exchange offering of new securities with a cash offering--have a number of obvious advantages from the point of view of debt management and System operations. There is, however, a disadvantage in that--for practical reasons--the System's options for exchanging its holdings of maturing issues are limited. As a result, the System's subscriptions tend to be predetermined by the Treasury's choice of a particular debt management technique--a situation that may not be the best for monetary management. This anomalous situation could be avoided if the suggestions contained in the memorandum were adopted by the Treasury and I commend them to you.

> I emphasize that what is involved is a technical problem and not a question of basic relationships between the Treasury and the Federal Reserve. I know that we both feel strongly that any Treasury offering must meet the test of the market and that the Treasury does not want to look to special System support of its financing operations. I am sure that we would agree also that it is essential for the Federal Reserve to have ample facilities for rolling over its holdings of maturing issues, including the possibility of subscribing to both long- and short-term issues in any optional Treasury refunding operation.

Chairman Martin then invited Mr. Holmes to comment on the experiment with a rate of interest above the discount rate on System repurchase agreements.

Mr. Holmes, noting that the subject was obviously controversial, observed that the previous long-standing policy of fixing the maximum rate on System repurchase agreements at the discount rate had been appropriate in the years when the Federal funds rate almost never exceeded the discount rate. A new situation had been created, however, when Federal funds began to trade regularly above the discount rate; in that situation more flexibility in the rate on System RP's seemed to be called for. The Desk's recent experiment with a premium rate on System RP's had not been an adequate test for two reasons. First, the market had been subjected to rapid shifts in expectations concerning eventual passage of the tax bill, and such a market atmosphere had not provided a suitable background for experimentation.

Second, the experiment, which had been initiated in early April, had been too brief.

In his view, Mr. Holmes continued, it should be possible to work out over time a more flexible rate on System RP's which would be geared to money market developments and which would not be viewed by the market as carrying significant policy implications. He believed that a variable rate could provide a useful addition to the tools available to the System. In the period immediately ahead, he thought it might be desirable to reduce the rate from the present 5-5/8 per cent to 5-1/2 per cent, the level of the discount rate. Such a reduction would be helpful if the Committee wanted to resist a possible rise in short-term interest rates.

Mr. Mitchell expressed the view that variations in the rate on System RP's could provide a useful device for transmitting subtle changes in System policy. He thought, however, that such variations should be reserved for the Committee's decision and that the Manager should consult with the Committee before making any change in the rate. In the present instance, the Committee should decide whether it wanted a 5-1/2 per cent rate. Earlier this month the rate had been reduced from 5-3/4 to 5-5/8 per cent and there had been discussions about a further reduction to 5-1/2 per cent. The Manager had decided against the additional reduction on the grounds that--given prevailing market circumstances--it was likely

to be interpreted as a policy shift which should be left to the Committee's decision.

Mr. Daane remarked that he had some sympathy for Mr. Mitchell's view. If there was a question of using the System RP rate as a policy instrument, then clearly the matter should be brought to the Committee for a decision. He understood that the Manager felt the same way. At the same time, he (Mr. Daane) thought the door should be kept open for some further experimentation when conditions warranted.

Mr. Bopp said he agreed with Mr. Daane. In order to achieve greater flexibility in the use of this instrument, however, he would suggest the establishment of an executive committee of the Federal Open Market Committee to be contacted when a policy decision about a particular RP rate had to be made on short notice. On occasion, as had occurred in recent weeks, it might not be feasible to reach the entire Committee quickly enough for a timely decision.

Mr. Brimmer commented that there was a question of amounts as well as timing involved in changes in rates on System RP's. He had participated in the recent morning conference call on the day when the decision was made to lower the System RP rate from 5-3/4 to 5-5/8 per cent. In his view the rate should have been reduced to 5-1/2 per cent, in light of the fact that the Committee had wanted to resist an upturn in interest rates. He had disagreed

with the Manager's judgment about the possible market reaction to the smaller reduction and had anticipated that the market would interpret even that action as signaling a policy change. The fact that that had happened confirmed the view that the market tended to look at the RP rate as a proxy for the discount rate.

Given the policy implications of changes in the RP rate, Mr. Brimmer continued, such changes should not properly be left to the discretion of the Manager. In the event that the System decided to implement the proposed restructuring of the discount mechanism, changes in the RP rate might well be tied to changes in the discount rate. To the extent that questions of timing still remained, Mr. Bopp's suggestion for an executive committee had some merit. In sum, he (Mr. Brimmer) was in favor of further experimentation but he felt the Committee should decide on the proper circumstances.

Mr. Hayes said he fully agreed that if the RP rate were going to be used as a deliberate policy instrument responsibility for it should not be left to the Manager but should be retained by the Committee or by a smaller group such as Mr. Bopp had suggested. He (Mr. Hayes) did not think it had been a foregone conclusion that the recent reduction in the RP rate would be interpreted as a policy decision. The Committee could, if it wanted to, use the RP rate as a policy instrument, but the System

had means of indicating that particular rate changes did not involve policy decisions and merely represented adjustments to market conditions. In that connection, the Committee might achieve greater operational flexibility if the Manager were allowed to decide whether or not to seek Committee approval for a particular rate change, depending upon his judgment as to whether or not the action was likely to be construed as a policy move.

Mr. Maisel expressed the view that the RP rate had special advantages as a policy instrument and should be used deliberately to achieve policy objectives. Changes in the rate provided a simple and ready means of signaling small policy shifts and thus were a welcome addition to the kit of policy tools available to the Committee.

Mr. Daane commented that the RP rate could be used as both an operational instrument and a policy instrument. There were occasions when money market rate relationships called for a change in the System's RP rate without implying a policy move.

Chairman Martin commented that, in light of the preceding discussion, members of the Committee should express their views in today's go-around before another change was made in the RP rate.

The Chairman then called for the staff economic and financial reports, supplementing the written reports that had

been distributed prior to the meeting, copies of which have been placed in the files of the Committee.

Mr. Wernick made the following statement on economic conditions:

> Now that the fiscal package has finally been enacted into law and the higher tax withholding rate is in effect, we can focus directly on the likely impact of current economic policies on the economy. The key question, of course, is whether the present fiscal-monetary mix will moderate inflationary pressures and help reduce our balance of payments deficit without at the same time causing too abrupt a curtailment of aggregate demand, sharp reductions in capacity utilization, and unacceptable levels of unemployment.
>
> Unfortunately, the clues needed for a firm answer to this anxious query are still well into the future. Employees have not yet received their first check reflecting the surtax. A strike in the steel industry still looms as a strong possibility in August, because the industry may not easily accept a 6.5 per cent wage package--especially in view of the large inventory overhang--and the unions are unlikely to accept anything less. In September, East Coast and Gulf longshoremen negotiations also pose a potential strike threat. Nor can disturbances in the cities this summer be precluded. So any view of the outlook must be hedged with even more than the usual cautions.
>
> But what we know of recent developments suggests a sharper slowing of expansion in economic activity for the remainder of the year than we had foreseen in the chart show presented to the Committee two months ago. The second-quarter rise in GNP is expected to be about as large as in the first quarter. More important, however, were the implications of the substantial shift in composition of demands that occurred. Gains in private final sales dropped substantially--rising only about $8 billion in the second quarter, compared to almost $20 billion in the first quarter. After adjustment for price increases there was practically no rise in real private takings last quarter. The appearance of strength in the aggregates came almost entirely from

a rapid step-up in inventory building and further large increases in Government expenditures.

Much of the slowdown in final sales was accounted for by uncertain consumers. Retail sales in June were little changed from May and were below the March peak; and, for the quarter as a whole, outlays were only moderately above the first quarter. Strength in automobile sales was a major exception, but in furniture and appliances and most nondurable goods, sales were disappointing. Thus the rise in consumer spending fell short of the substantial increase in disposable income, and the saving rate bounced up again to about 7.5 per cent, after having dropped to about 6.5 per cent in the first quarter.

The business fixed investment sector was another source of weakness. Capital outlays--including commercial and industrial construction--declined in the second quarter and were well below those anticipated by the recent Commerce-SEC survey. Despite extremely strong demands, housing starts were down sharply in May, and based on May permit data little recovery is expected in June.

Signs that upward pressure on prices and resources were beginning to moderate also became apparent toward the end of the quarter. Industrial prices were rising less rapidly than earlier in the year and the production index was leveling off. Gains in nonfarm employment fell to about half the first-quarter rate, with construction employment in a downtrend since February. A rise in the unemployment rate to 3.8 per cent in June mainly reflected a large influx into the labor market of young workers who could not find jobs, but higher unemployment among new workers often in the past has signaled growing labor market ease.

In the current quarter, the new fiscal restraints added to the lagged effects of earlier monetary policy and a certain slowing of inventory accumulation seem bound to reduce growth sharply. The current green book projection indicates that real GNP would come to a standstill, with average hours of work declining and unemployment rising. Whether growth halts completely or merely limps along showing very modest gains, the range on the plus side appears quite limited.

Perhaps volatile consumers will start spending more freely again, but any tendency toward renewed buoyancy in consumption is likely to be dampened by the tax increase.

Higher withholdings should just about absorb all the modest rise in personal income this quarter, so disposable income is likely to show little gain. In fact, it will take a considerable drop in the saving rate merely to repeat the relatively small second-quarter rise in consumer expenditures.

The greater-than-anticipated decline in business capital outlays in the second quarter and prospects for lower capacity utilization rates and profits suggest little, if any, further expansion in business investment expenditures this year. Outlays for residential construction will undoubtedly be off this quarter, reflecting the recent decline in housing starts. Starts will have to rise fairly soon if an upturn in residential expenditures is to take place this winter.

But it is in the area of inventory investment where cutbacks are likely to have the greatest impact on output and incomes. A steel settlement in August would bring a substantial letdown in production, but even so it would probably take until year-end to bring stocks back to desirable levels. Activity is also likely to be adversely affected in the consumer goods sector as attempts are made to bring merchandise inventories in line with the slower growth in sales. While the extent and timing of cuts in Federal expenditures are still problematical, retardation in new orders for military goods is probable this quarter and may be accompanied by inventory retrenchment.

At a minimum, it now seems certain that the restraints on aggregate demand will act to preclude any further upward twist in the inflationary spiral. In fact, the prospects for some slackening in price pressures seem favorable. With competitive conditions intensifying, the rise in industrial prices could moderate somewhat further as business finds it increasingly difficult to push through cost increases. Some slowing in the rise in consumer prices also seems likely in line with the early 1967 experience, when the GNP deflator declined from an annual rate of 3.5 per cent in mid-1966 to 2 per cent in the second quarter of 1967 as growth in output eased.

Moderation is less imminent on the cost-push side, but the steady acceleration in wage rate increases, which has occurred since 1965, could be reversed next year. Easier labor market conditions should begin to have an influence on wage patterns. Moreover, the calendar of new contract reopenings in major industries is relatively

thin after the current steel negotiations are completed, and average wage increases will be weighted more by the smaller advances provided in the second year of most existing contracts. Increasingly, it is likely to be the detrimental effect on productivity of the reduced pace of activity, rather than rising wages, which determines how fast unit labor costs will rise.

Although the much-needed cooling-off period is only beginning to get under way, the prospective economic picture strongly suggests that the present fiscal-monetary policy mix could lead to an abrupt halt in the expansion of production, incomes, and employment. Assurance of a significant upturn in construction activity seems even more necessary now than it did to us earlier, to counteract any excessive slack that may develop in other private and Government demands. To me, the risk of a resumption of overheating appears small. The greater risk, given the lags in policy effects on real demands, is too sharp a deceleration of economic growth and too high a rise in unemployment.

Mr. Daane asked Mr. Wernick when he thought the effects of fiscal restraint would begin to be felt in the economy and in what sectors such effects would initially appear.

Mr. Wernick replied that the fiscal restraint measures might start to influence the economy by August or September of this year. He did not think there would be any effect in July, which would be a month of strong economic activity. The first indication of slower growth was likely to show up in inventories. Large steel inventories had been accumulated in anticipation of a strike and even if the strike failed to occur, a sizable decline in such inventories could be expected. There also were large inventories of automobiles, despite good sales, and these too could be expected to be worked down through a longer model-changeover

period. Inventories of other durable goods should likewise decline by late summer. The recent tax increase would, of course, tend to hold consumer expenditures down. The unemployment rate would at the minimum be maintained at the 3.8 per cent June level and might go up to 4 per cent by September or October. The average workweek should also diminish in this period. In sum, signs of slowing in economic activity should be evident in the data received in September.

Mr. Hickman inquired whether the first signs of slowing in the rate of economic growth might not have begun to appear in the third quarter even in the absence of a tax bill, given the delayed effects of restrictive monetary policy.

Mr. Wernick thought the slackening of private final sales in the second quarter already implied a significant slowing in third- and fourth-quarter economic activity even without a tax increase. As a result of the weakening in the second quarter and unless spending by consumers picked up, over-all economic activity in the last half of the year would be weaker than was projected by the staff in late May.

Mr. Brimmer noted that Mr. Wernick had suggested there was a greater need now than the staff had foreseen earlier to provide additional stimulus for housing. He (Mr. Brimmer) recalled that in late May the staff had projected a decline in housing starts

in the third quarter and a further decline in the fourth. He thought that adoption of an easier monetary policy stance at this time would not affect housing outlays in the third quarter and might not begin to influence such outlays much before the end of the year.

Mr. Wernick agreed and noted that if the Committee started to ease policy now, some stimulus to housing starts might be provided by winter. Monetary restraint had had a considerable dampening impact on construction activity in recent months and was likely to continue to be felt in the period immediately ahead.

Mr. Brimmer suggested that the Committee's attention should be focused on the fourth quarter since for all practical purposes any policies adopted now were not likely to have much influence on third-quarter economic activity. He noted that the staff was predicting little or no real economic growth in the third quarter.

Mr. Wernick agreed that real growth was likely to be quite small in the third quarter and might even be negative in the event of a long steel strike. That projection was not universally accepted, however. Many forecasters placed more emphasis on signs of current strength in the economy, and, as he had noted earlier, the pace of over-all activity was likely to continue strong in July.

Mr. Hayes noted that the staff at the Federal Reserve Bank of New York was projecting a much more rapid rate of economic

growth than that suggested by the Board staff, and he would have more detailed comments to make during the course of today's go-around.

Mr. Axilrod made the following statement regarding financial developments:

> At the previous meeting of the Committee, the two chief financial problems appeared to be: (1) how would credit markets react to passage of fiscal legislation; and (2) would this reaction come soon enough or be extensive enough to avert serious problems for banks and thrift institutions at the mid-year interest-crediting period, and perhaps encourage a more permissive attitude toward mortgage lending on the part of these institutions. The staff view of the longer-run outlook for an economy reined in by fiscal restraint still puts a lot of weight on a rebound in housing activity next winter as necessary in avoiding too sharp a slowdown in GNP.
>
> It would appear that in the weeks after mid-June the over-all tone of credit markets has become somewhat more relaxed--though perhaps not as relaxed as some optimists may have anticipated. The critical questions now are whether the degree of relaxation attained is enough, whether it is likely to be extended, and whether, given the economic outlook, it should be.
>
> Evaluations of how the current stance of monetary policy fits into the credit market outlook will differ in part depending on whether recent tendencies are based more on expectations than on current flows of funds. Expectations of greater monetary ease have been a principal element in the credit market picture, especially as affecting yields in the Treasury bill market and in Government and private bond markets. In addition, banks and thrift institutions do appear to be experiencing inflows of time and savings accounts that are larger than they anticipated, but it is a little early to be able to appraise the institutional results with any real assurance.
>
> The position of banks began to become less constricted after mid-June, when CD attrition in connection with the tax date was relatively moderate and when subsequently banks were able to begin rebuilding outstanding CD's at

a relatively rapid rate. Not only were domestic funds for CD's more available as Treasury bill rates declined, but also uncertainties in international financial markets increased availabilities of Euro-dollars. Finally, recent fragmentary data suggest that the net inflow of consumer-type time and savings deposits to banks may be at a somewhat more rapid pace than in the spring. This pick-up in availabilities has been accompanied by some reductions in interest rates offered by banks for large negotiable CD's, probably because banks expect interest rates to decline as a result of further monetary ease, but also probably because they are uncertain whether loan demands will be very sizable in late summer and fall.

The available data for mutual savings banks and savings and loan associations in recent weeks and days have been described in the green book and its supplement. Though not unequivocal, those data suggest that the cautionary attitudes of these institutions toward committing funds for future lending might be modified, at least at those institutions which had been preparing for the worst. But I would not expect very much of an increase in commitment activity by the thrift institutions in general unless they have reason to believe that net inflows will be even larger in the months ahead; and this is likely to depend on further evidences that interest rates on competing market instruments will be declining. Still, it would appear that the crest of tightness in mortgage markets may have passed; at least market participants expect so, as indicated by declines since mid-June in the auction yield on 6-month forward FNMA commitments.

Perhaps the most surprising development since the last meeting of the Committee has been the resistance of corporate and municipal bond markets to interest rate declines. This was partly explained by the very large calendar of new issues in those markets. But it was also explained by the wait-and-see attitude of investors. Some investors may have been looking for signs of monetary ease following the tax increase. Others, more prosaically, were simply waiting for the large Jersey Standard bond issue to be marketed. However one may weigh investor motives, corporate and municipal bond yields did finally decline 5 to 10 basis points last week. These declines appeared to reflect the very

successful offering of the Jersey issue, evidences of some increased commercial bank interest in State and local government securities, and reports that investors were becoming more convinced that monetary policy was in the process of, or about to, ease.

I would judge from recent developments that much of the modest credit market ease set in motion during recent weeks has been predicated on market attitudes that monetary policy has just begun to reduce restraint and has a way to go. Thus, it would appear that further relaxation in credit markets might be quite limited unless the market discerns that policy is shifting significantly. Indeed there could be some reversal over the short run in the absence of further policy moves and in light of the various Treasury financing activities--even though over the longer run interest rates may tend to decline as private and Federal Government credit demands abate, and as or if signs of economic weakness develop.

To me, it seems as if the economy needs the additional degree of ease the credit markets are likely to deliver in the short run if the Committee were to take a step toward reducing restraint today, a step that would have to be accomplished within the next ten days in view of even keel considerations and Treasury pricing problems in the mid-August refunding. If the Federal funds rate were moved down to a consistent 5-3/4 per cent area, Treasury bill and other short-term market rates would likely move down another notch (say 10 to 25 basis points), and long-term rates would probably follow, pulled along by more widespread expectations that interest rates were past their peak and not yet near their trough. Such a move through open market operations would be modest, but would be a step toward putting monetary policy in the posture of beginning to encourage credit demands so as to attempt to avert undesirable economic weakness--rather than letting credit market ease develop as a result of economic weakness and associated reduced credit demands.

It may seem venturesome to speak of the possibility of reduced credit demands when the blue book is projecting a sizable bank credit expansion for July-August on average. But a very substantial part of that credit growth is the result of the Treasury's immediate cash needs during the two months. We are anticipating reduced private demands both at banks and in bond markets as the summer progresses,

> influenced by a reduced rate of inventory accumulation and, as economic activity slackens, by growing business doubts about whether their over-all need for funds in the months ahead will be very great.
>
> The kind of policy move suggested above may lead to an even more sizable bank credit expansion in the short run, as banks seek to restore liquidity and rebuild portfolio positions. There may also be a somewhat greater inflow of funds into thrift institutions, which would be usefully channeled into the mortgage market. But, over-all, banks and other institutional lenders are likely to be conservative in their approach to lending terms--perhaps overly conservative given the economic outlook--so long as the degree of monetary ease developing appears relatively limited to them.

Mr. Mitchell observed that Mr. Axilrod's interpretation of recent market developments seemed to be at variance with that of Mr. Holmes. Mr. Axilrod appeared to be stressing expectations while Mr. Holmes gave primary emphasis to the Desk's operations.

Mr. Axilrod noted that there might not in fact be much difference between his interpretation and the Manager's since Mr. Holmes had reported that expectations of easier monetary policy were important up to the last few days when such expectations began to wane. It was now possible, Mr. Axilrod thought, that interest rates could back up somewhat in the absence of further monetary easing moves. The higher rates set in yesterday's weekly bill auction might be symptomatic of such a backup.

Mr. Mitchell commented that the latest auction average for the 3-month bill was 5.47 per cent, up 10 basis points from

the previous week. He wanted to know what complex of money market conditions Mr. Axilrod had in mind when he made reference to possible further monetary easing.

Mr. Axilrod replied that such conditions might include a Federal funds rate around 5-3/4 per cent.

Mr. Daane asked whether Mr. Holmes also anticipated some backup in interest rates in the period ahead.

Mr. Holmes replied that he was not sure. The upturn of recent days was partly due to technical market developments. The market had been expecting the System to be a buyer of Government securities, but foreign operations had provided enough reserves to require sales instead. The upturn in interest rates might therefore be temporary. On the other hand, if expectations concerning easier monetary policy were jarred in some important respect, rates could move up. Even so, the underlying atmosphere in capital markets was indicative of a downtrend in yields.

Mr. Axilrod noted that, as the Manager had implied, there was a distinction to be drawn between the short-run and the longer-run prospects for interest rates. He agreed with Mr. Holmes that market forces were for lower interest rates over the longer run, in part as a result of weakening demand pressures. The issue which seemed pertinent at the moment was whether or not the Manager should be instructed to ease ahead of these developments

in his operations so as to provide encouragement from the supply side for interest rate declines and thus move ahead of any prospective economic weakness.

Mr. Hickman recalled that he had seen some comments in the press to the effect that a System attempt to lead interest rates down might cause bond market investors to hold back and capital market borrowers to anticipate their needs in the expectation that monetary policy would have to reverse itself later. He wondered if Messrs. Axilrod and Holmes had any comments about that line of reasoning.

Mr. Axilrod said he did not think there would be a repetition of the experience of 1967, when monetary policy easing had been accompanied by a rise in long-term interest rates. Under current circumstances, he thought that lower bond market yields would serve a useful function in encouraging lenders to commit more funds to the mortgage market. A sign, even a limited one, that monetary policy was moving toward ease was important in any effort to foster lower bond yields in the period ahead.

Mr. Holmes said he was in essential agreement with Mr. Axilrod, although there might be some differences of emphasis between them. If bond market yields continued to decline, institutional lenders would have an added inducement to make commitments in the mortgage market, where rates typically were

more sluggish in adjusting downward. Such lenders would worry later about getting funds to cover their commitments.

Mr. Maisel noted that inflows of funds to savings institutions were still relatively small. He wondered how large such inflows needed to be before the institutions became more willing lenders.

Mr. Holmes replied that loan commitments tended to be made on the basis of a flow of funds that was expected to develop over time. Accordingly, lenders would tend to increase such commitments if they foresaw easier credit market conditions and a slowdown in economic activity.

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

> The over-all balance of payments figures for the second quarter are still incomplete and are not scheduled for public release until mid-August. But already word is beginning to leak out that they will show a dramatic improvement. The published liquidity deficit will show a sharp drop to an annual rate of less than $1 billion, the smallest since the spring of 1966. And the balance on the official settlements basis will have swung into record surplus.
>
> Unfortunately, these encouraging developments seem to be temporary--the result of unusually large inflows of foreign capital that are bound to subside fairly soon. They have provided a welcome respite for the dollar in foreign exchange markets but, as Mr. Coombs has observed, the respite is likely to be brief. With the balance on goods and services at its lowest ebb since 1959, and with domestic inflation still threatening further erosion of our international competitive position, the underlying payments position must still be regarded as unsatisfactory.

The inflows of foreign capital that have recently been unsustainably large are of four main types. First, there has been an unusually large volume of special official financial transactions--a switching of foreign official reserves, mainly Canadian and German, from liquid U.S. assets into technically nonliquid assets, with beneficial effect on the published liquidity deficit. Most observers would regard these switches as a form of statistical window-dressing. In any case, they cannot long continue at the second-quarter rate of more than $900 million in a single quarter. Had it not been for the increase in such transactions during the quarter, the liquidity deficit would have shown no improvement, and would have remained at about a $4 billion annual rate.

The next two categories of unusual inflow have been flows of foreign private capital into U.S. corporate stocks and into Euro-bond issues of U.S. corporations. Foreigners made net purchases of more than $600 million of U.S. equities during the first 5 months of this year (not counting the large direct investment in the Shell Oil Company). For the half year, such purchases may have exceeded the previous half-yearly record of $660 million set in the second half of 1967. There has been no inflow of remotely comparable size in any earlier period. While we do not fully understand the reasons for this extraordinary surge, it would not seem prudent to expect it to continue on the recent scale, especially if the domestic economy should cool off, as projected, and corporate profits should begin to shrink.

At the same time that foreigners have been buying U.S. equities, they have also been buying the convertible Euro-bond issues of U.S. corporations in record volume--$1.1 billion in the first half year, compared with less than $1/2 billion during the whole of 1967. Here, too, the pace seems bound to slacken considerably. U.S. corporations were driven to heavy Euro-bond financing by the new mandatory direct investment controls, and they found the first half year a particularly good period to do it, with U.S. credit conditions tight and foreign conditions generally easy. But it appears that only about one-fourth of the proceeds of these Euro-bond issues have yet been transferred to foreign affiliates. The corporations borrowed ahead of their needs, and now can slow down on new issues while still complying with the Commerce program by drawing on the proceeds of earlier borrowings.

The fourth unusual inflow, as you well know, has been the flood of foreign liquid funds that has poured in from commercial banks abroad--especially from the foreign branches of U.S. banks operating in the Euro-dollar market. These inflows do not affect the liquidity deficit, but are responsible for much of the huge recent favorable swing in the official settlements balance. The staff has never claimed great expertise in forecasting these liquid flows, and has lately been proven wrong on even its roughest guesses. Specifically, the inflows have continued longer, and at a heavier rate, than any of us would have thought possible a few months ago.

However, we are not entirely without explanations, and all the available explanations still lead to the conclusion that these liquid inflows must soon subside. The factors that produced the record $2 billion inflow from bank branches in the second quarter included, on the supply side, the confidence run on sterling and on the French franc, the ease of monetary conditions in Germany and some other countries, and the heavy volume of Euro-bond issues in advance of need for the proceeds. On the demand side, credit tightness at home made U.S. banks eager bidders for the available funds. All of these factors are now changing, and the changes ought fairly soon to reduce both the availability of Euro-dollars and the willingness of U.S. banks to bid for them.

We cannot put precise figures on the likely change in all these inflows of foreign capital, liquid and nonliquid. But it may be roughly guessed that the inflows of foreign private nonliquid capital may shrink by half, or by nearly $2 billion at an annual rate, in the second half year. There may well be an offsetting improvement on the current account. But that would still leave the liquidity deficit--before official transactions--as high as before, at an annual rate of around $4 billion.

In addition, an expected marked slackening in the inflow of foreign liquid funds seems likely to swing the official settlements balance back into deficit fairly soon. To the extent that this deficit has its counterpart in a developing U.K. payments surplus, it will not be wholly unwelcome and will not be difficult to finance. But probably some of our deficit will be reflected in surpluses for countries that do not particularly want to

add to their official dollar holdings and may ask for gold or IMF claims. In addition, we know that some countries want to convert some of their existing dollar holdings into gold; the list includes Portugal, Thailand, and Argentina. Incidentally, in these cases, it may do the dollar more good if we simply deliver the gold upon request than if we remonstrate and attempt to head off or delay all such sales by peddling special Treasury securities or rushing to offer exchange rate guarantees.

I doubt very much that ebbing of foreign capital inflows will be greatly affected either by a modest easing of monetary conditions, if the Committee deems that appropriate for domestic reasons, or by a decision not to ease. For example, neither action can keep the stock market bubbling indefinitely. Or, in the case of liquid flows, if there is some reflow of foreign funds out of Euro-dollars into sterling, or a cessation of outflows from the French franc, these changes will occur as a result much more of changing attitudes about those currencies--reflected chiefly in changing forward discounts--than of small changes in interest rates levels or an absence of such changes.

The main balance of payments considerations for policy, in my view, still relate to inflation and the current account, rather than to the capital account. From this point of view, it should be emphasized that the trade balance was still worsening through May, the latest month for which we have data, with rapidly rising imports still flashing a clear inflationary signal. The hoped for reduction in excessive domestic demand pressures is still largely prospective. Naturally monetary policy must look ahead and take account of lagged responses, and there may be a need now to signal some slight easing intention in order to stimulate an appropriate amount of mortgage financing for the coming winter. But if so, I would hope on balance of payments grounds that this could be done through a gentle nudge from open market operations, and that any marked and overt move could wait until we have seen some clear indication of a turn for the better in our international trade.

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

It seems to me that we face a very important policy decision today. The choice, as I see it, is whether to risk nullifying many of the benefits of the long-sought tax-spending action through premature easing as a result of fears of an excessive business slowdown, or whether to hold firm to present policy until we can get a clearer view of the impact of the fiscal move on the economy. I am impressed by the vital necessity, on both domestic and international grounds, of checking the rampant inflationary forces that have dominated the economy for the better part of three years, and accordingly I conclude that we should not change policy at this time.

Let me try to outline briefly the reasons for this conclusion. With respect to the economic outlook, a sharp drop in the rate of growth was bound to come in the second half of 1968, regardless of fiscal action; but in the absence of that action the slowdown would have fallen far short of what was needed to provide any significant reduction of inflationary pressures. At this juncture we simply cannot measure accurately whether the fiscal program will introduce too much, too little, or just the right amount of braking influence. Much depends on the consumer's reaction as to the proportions of income to be spent and to be saved; but the tremendous accumulation of past savings points to the possibility of relatively liberal spending policies even in the face of higher taxes. The prospect is for moderate further gains in business capital spending and for substantial further gains in State and local government outlays. The over-all inventory situation, despite some accumulation in the steel industry (especially among steel consumers) and perhaps elsewhere, does not involve a serious overhang problem. Perhaps most important, recent developments with respect to flows of funds to savings institutions and availability of mortgage funds from those institutions suggest a much stronger housing outlook than has been projected in the economic analyses presented at recent meetings of the Committee. Our economists see little likelihood of any major weakening in housing construction in the months ahead.

The improvement in the competitive position of thrift institutions has been dramatic. Indeed, as recently as late May, the yields on U.S. Government securities with maturities running from 1 to 5 years averaged about 140

basis points higher than average rates offered on thrift deposits. Since then, however, this yield differential has been cut almost in half, and is now about as favorable as at any time this year. Given a continuation of present rates in the market, it appears likely that thrift deposits will show a faster rate of growth in the second half of this year than the first, the income tax surcharge and the expected slower rise of personal income notwithstanding.

Admittedly, the probability of a steel strike is a significant unsettling factor, but clearly its influence would be temporary. And we should guard against being unduly disturbed by relatively small swings in the unemployment figures such as we encountered in June. That rise was due mostly to an abnormally large number of young people looking for work, and in fact labor force increases have been abnormally high for the past year or two. Some slowing of the economy could easily cause withdrawal from the labor force of some of those involved in these unusual recent gains.

Price and wage prospects are seriously inflationary. With consumer prices continuing to rise at about a 4 per cent rate, there is no sign of slackening in labor's demands. The green book mentions a 7-1/2 to 10 per cent range of first-year wage increases. Temporary factors account for a good part of the slowdown in the rise of industrial wholesale prices in the second quarter, and the resumption of a more rapid rate of increase should be expected despite the projected easing of demand pressures.

On the international side, our underlying balance of payments deficit remains very large, with a major improvement in capital flows being offset by a serious deterioration in the trade surplus. The published liquidity deficit in the second quarter will probably be much smaller than in the first quarter, and the official settlements balance will doubtless be in tremendous surplus. But we can't count on indefinite continuance of the elements that brought those results, such as unusually large window-dressing operations, a very heavy flow of foreign capital into the U.S. stock market, very large purchases of U.S. corporate offshore bond issues, a rapid run-up in American banks' liabilities to their foreign branches, and the difficulties of the French franc and sterling. We may welcome the much better position of the dollar in exchange markets reflecting

those factors and the relatively low level to which central bank dollar accumulations have been reduced. However, we should bear in mind that tight money conditions in the U.S. have contributed importantly to these beneficial developments. Above all, we should recognize that unless we can restore a reasonably satisfactory trade surplus, the dollar will surely be in serious trouble again within the coming year. Thus it is imperative that there be enough of a cooling-down of the economy to give a sharp check to imports and to break the force of the wage-price spiral in which we are caught.

I therefore come back to the view that we should welcome a very material slowdown in the growth of GNP, whether measured in dollars or in real terms. I see no evidence that such a slowdown would be likely to turn into a recession. Indeed, the ultimate danger of recession would be much less from such a course than from allowing the inflationary spiral to continue unchecked for many more months. All of us have worked long and hard for a sound fiscal program. Now that we have it, let's stop, look and listen before altering course on monetary policy.

On the whole, performance of the major credit statistics in the first half of the year was quite appropriate. I am not too concerned over the rapid growth of the money supply in the second quarter, in view of the important role played by declining Government deposits and the moderate growth of bank credit as a whole.

It would seem desirable to conduct open market operations in such a way as to maintain about the present degree of firmness in money market conditions. Passage of the tax legislation has in itself induced some decline in interest rate levels through changing market expectations, and I think we have been right in letting this occur without interference. But I would hope that we could pursue a wait-and-see course for the next four weeks, without trying to lead the market in either direction. The specifications as to market indicators prevailing since the last meeting might be continued, i.e., a Federal funds rate of about 6 per cent or a little above, a 90-day bill rate of 5-1/4 to 5-1/2 per cent, borrowings fluctuating around $600 million, and net borrowed reserves of $300 to $400

> million. Under these conditions, interest rates--particularly in the long-term market--might well ease somewhat as the reduced financing demands of the Treasury are more fully recognized.
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> As for the directive, it seems to me alternative A is clearly preferable, as it permits confirmation of the somewhat easier money market conditions that developed in the wake of the tax action, but without moving deliberately further at this time. Alternative B, on the other hand, seems premature under present conditions. I would also add to the statement concerning price developments in the first paragraph the phrase, "and wage pressures remain strong".

Mr. Francis commented that the Federal budget situation had cleared considerably since the Committee's previous meeting. Since stabilization policy was a mix of fiscal and monetary action, the Committee could now better evaluate the requirements for monetary policy in light of recent budget developments. No doubt the budget would be less expansionary with the new fiscal package than it would otherwise have been. However, he did not believe that the new fiscal program was restrictive enough to bring an end to the inflationary spiral unless the rate of monetary expansion was significantly abated.

Mr. Francis did not agree with the extreme view that the new fiscal package might "overkill" the economy. Much of the effect of the fiscal restraint would not be felt until the next calendar year. At least until the first of the year, he believed the economy would be more influenced by the delayed effects of recent monetary expansion than by the budget program.

Some had expressed concern that the price of curbing inflation would be a higher rate of unemployment, Mr. Francis continued. Although the response to a slowdown in spending was usually quicker on employment than on prices, the experience of late 1966 and early 1967 suggested that that concern need not be too great. In that period, the earlier move toward great monetary restraint was followed by a decrease in the rate of inflation from a 3.3 per cent annual rate to a 2.3 per cent rate. At the same time, the unemployment rate was little changed in late 1966 and early 1967. Even if, in response to policy actions designed to reduce the rate of inflation, the unemployment rate were to rise temporarily to as much as 4.5 per cent, that might be a relatively small price to pay to reduce the serious inflation. If policy were firmed sufficiently to eliminate the demand for workers that industry could not get at the present time, inflationary pressures would be eased.

Mr. Francis said that the new budget situation had removed one constraint on monetary action and had given the System a chance to adopt a policy which would assist in halting the acceleration of total demand and in gradually reducing the rate of inflation. In his judgment, a 6 per cent growth of total demand would be a reasonable target for the year ending with the second quarter of 1969, meaning a GNP rate of about $900 billion in that quarter.

If the recent 7 per cent rate of monetary expansion remained unchanged, and if the fiscal legislation had not been passed, his staff had estimated that the increase in GNP would have been about 9 per cent, or to about $925 billion in the second quarter of 1969. They further estimated that the fiscal package alone would not provide the desired reduction in the rate of spending. To reduce the growth of total demand to 6 per cent, monetary growth as measured by the money stock needed to be reduced from the recent 7 per cent rate to not more than 4 per cent per year.

Mr. Francis expressed the view that if the Committee desired to limit the growth of total demand adequately, the rapid monetary expansion of the recent past should not be continued. The money supply had grown at about a 7 per cent rate over the past six months and at an 8 to 9 per cent rate during the past three months. Actions should not be taken which would allow the growth of money to continue at such high rates. He believed that a more moderate rate of increase in money was a necessary complement to the new fiscal stance in order to achieve the limitation of total demand and of inflation that was desired. Similarly, the rate of increase of bank reserves, of the monetary base, and of Federal Reserve credit should not be accelerated, but moderated. Accordingly, he suggested that the System aim for a 3 or 4 per cent rate of increase of money rather than the abnormally high rate of the past six months.

The blue book suggested, Mr. Francis continued, that the System should now expand bank credit and the money stock to help finance $7.5 billion of Treasury borrowing and to help finance the public's additional tax burden. He did not believe that such actions were appropriate in view of expressed desires to limit total demand so as to curb the present inflation.

Mr. Francis thought interest rates would no doubt be lower under the new budget situation than they otherwise would have been. However, they would not necessarily be lower than they recently had been. The upward trend of interest rates would be weakened as a result of relatively lower demand for funds by the Government. On the other hand, corporate demand for funds might be increased, and the public's supply of loanable funds might be reduced by the tax increase. Also, the level of nominal interest rates depended to a great extent on expectations regarding inflation. If the public anticipated future price rises of 3 per cent a year, then nominal interest rates of 7 per cent meant real rates of 4 per cent, a very low rate in view of the current high productivity of capital. So, he thought it would be a great mistake for the Federal Reserve to take any overt steps to reduce current nominal interest rates.

Mr. Francis observed that some analysts had been inclined to use bank credit as an indicator of the thrust of monetary

stimulus rather than the money stock. At times the growth of either of those magnitudes, properly interpreted, would yield the same conclusions with regard to the thrust of monetary policy. However, the lack of growth of time deposits in recent months was directly attributable to the interest rate ceilings imposed by Regulation Q in the face of high and rising market rates of interest. Therefore, since the growth rates of bank credit in the absence of that artificial constraint was not known, it seemed to him that that measure was at present a less accurate indicator of the thrust of policy than was the money stock.

Mr. Francis concluded that the open market operations of the near future should be conducted with a view to moderation of the growth rate of money through appropriate adjustment of the growth rate of bank reserves and Federal Reserve credit. With a moderate rate of monetary expansion, the Committee should accept those interest rates which market forces produced, whether or not the rates were less than those of the recent past.

Mr. Kimbrel reported that several matters that worried him about the Sixth District economy had eased. The crisis atmosphere that began to develop among some thrift institutions in early June now was gone. Those institutions were not experiencing the savings outflows predicted before passage of the tax bill. Spot checks showed that the District savings and

loan associations had a much better than expected reinvestment period. He also noted that the District banks picked up a more than usual time deposit inflow in early July. Indications were that the smaller banks added considerably to their consumer certificates, while the larger ones continued to increase their large-denomination CD's.

Continuing, Mr. Kimbrel reported that another worrisome sector, construction activity, had held up reasonably well, at least through May. In fact, residential contracts in May rose sharply. To a great degree, that reflected some large multi-family projects in Florida, where contracts this year had been running 58 per cent ahead of 1967. Although there was, of course, a distinct possibility of an eventual decline in construction, the latest available construction figures for the District showed no sign of it yet.

Mr. Kimbrel commented that a further development of concern for some time had been the rapid growth in bank lending. Considering the amount of inflation that was being experienced, the 10 per cent annual rate of growth in total loans at District member banks in the first half of 1968 was more than he would have liked to have seen. Therefore, he was not at all unhappy to have noticed a moderation in lending activity by the District's large banks in late June and a decline in early July. Such slowing down

in bank lending was precisely what the economy needed if the Committee was to do any good in breaking the inflationary spiral. However, with seasonal and tax needs ahead, loans could rise again in the near-term. Hence, it seemed premature to conclude that the recent moderation in bank lending in the District reflected a genuine drop in loan demand.

So far as the national picture was concerned, Mr. Kimbrel recognized that recent money market developments suggested to some observers that changes in the credit climate had already occurred. He, himself, found it very difficult at this point to determine for certain how much those changes might reflect expectational forces, Treasury operations, demand factors, and the Committee's own actions. Therefore, in determining the appropriate policy posture he thought the Committee should be guided more by the broader economic situation, international considerations, and the domestic price picture.

As he had observed at the previous meeting, Mr. Kimbrel continued, the effects of the fiscal restraint had yet to be felt. He gathered from the green book that there had been no fundamental improvement in the U.S. balance of payments, and there seemed to be no evidence of any slackening in consumer prices. Indeed, he would agree with those who had observed that inflation might have become so ingrained in the economic system that it would take a

substantial dose of combined fiscal-monetary restraint to check it. Judging from the past growth in the money supply and bank lending, present monetary policy did not appear overly restrictive. Thus, he would like to see more evidence of a slowing down in the economy than was available to the Committee today before moving toward ease. In fact, he would very much hope that the Committee could agree today on a reasonably firm policy course.

Mr. Kimbrel commented that taking a stand on monetary policy was not like taking a stand on a tax increase where one was either for or against it. As it became necessary, this Committee had opportunities to adjust its policies from time to time. Favoring a directive of no change, he liked alternative A best, with the added hope that the Desk would resolve any marginal questions on the side of firmness.

Mr. Bopp said that since the last meeting he had been on the daily conference call and involved in the day-to-day tactics of implementing the Committee's strategy as outlined in the directive. He could report first-hand that achieving the directive's goals had not been without problems. In general, money market conditions had eased but indicators had been confusing. In spite of the substantial declines in net borrowed reserves, Federal funds rates had declined only slightly and rates on corporates and municipals had continued firm at least until the

past few days. There had been difficulties with reserve projections and substantial revisions.

In Mr. Bopp's view, the Desk's tactics in response to the many uncertainties had been appropriate. In particular, he had in mind the reduction in the RP rate when market psychology was threatening to produce money market conditions contrary to objectives of the directive.

As Mr. Bopp read it, the market had thus far been drawing the correct conclusions about the recent slight shift in monetary policy. The sharp decline in borrowed reserves last week had been interpreted as caused by special factors. Nevertheless, dealers had been building up their inventories, and the most recent market reception of corporates and municipals had been consistent with expectations of rate declines. Official pronouncements from Washington continued to stress the desirability of lower interest rates, and the danger of overkill was very much in the news. Although there was still considerable uncertainty about what the Federal Reserve intended to do, the buildup of dealers' inventories suggested that expectations of a positive move to ease might spread during the next several weeks.

Mr. Bopp believed that to discourage those expectations might mean a sharp turnaround in rates, an increase in market uncertainty, and pressure on dealers. Yet, inflation was a

continuing problem. Looking down the road, he anticipated and welcomed some moderation in the rate of economic growth but did not now see much danger to the forward movement of the economy. He was no more sanguine now than four weeks ago about the likelihood that the Government would achieve a $6 billion reduction in total expenditures. In fact, that view had been reinforced by the recent supplemental appropriation of $6-1/2 billion for Vietnam for fiscal 1968, which was over $4 billion in excess of the forecast. The U.S. balance of payments problems were still far from a solution, and even with the recent credits, problems of the pound and franc posed further perils for international monetary stability.

In addition, Mr. Bopp continued, the money supply had increased rapidly since the first quarter, and the projected increase for July was in the 8 to 10 per cent range. That growth, of course, had been due in part to special factors, as behavior of the proxy illustrated. But even the proxy was forecast to resume rapid growth.

Therefore, Mr. Bopp would vote to maintain money market conditions essentially as they now were. If and when the market interpreted Federal Reserve actions as indicating that no further move toward ease was in process, rates might tend to overreact. He would give the Desk discretion to use the tactics it thought appropriate to dampen such short-term movements.

In summary, Mr. Bopp said he was not as pessimistic about the economic outlook as the staff report. He preferred alternative A for the directive and would agree with Mr. Hayes' suggested change in the first paragraph.

Mr. Hickman observed that economic activity in the nation was moderating on a broad front. The pace of consumer spending and manufacturing and construction activity had slackened appreciably, thereby portending sharply reduced rates of gain in GNP in the second half of 1968. Nevertheless, wages and prices were still surging upward and would continue to do so until the slackened pace of economic activity had taken its toll.

As usually happened, Mr. Hickman said, signs of moderation were even more pronounced in the Fourth Federal Reserve District than in the nation. The Cleveland Bank's July survey of Fourth District manufacturers showed actual declines in such series as new orders, backlogs, and the workweek. Manufacturing activity was declining fairly generally in the District; construction contracts had weakened considerably more than in the nation; and insured unemployment rose in June for the second consecutive month.

In the context of developing slack in the economy, monetary policy should resist any tendency for bank credit to decline, Mr. Hickman continued, but should not overreact to the reduced rate of economic growth that was now emerging. The intent of

public policy was to arrest price inflation and improve the nation's balance of payments, which required a reduced rate of economic advance such as was now being experienced. Accordingly, the Committee should not attempt to offset through monetary policy the fiscal restraint now in train.

Mr. Hickman thought the Committee should seek to restore, as soon as possible, balanced growth in the economy and to provide a volume of money and credit consistent with that growth. He would therefore prefer alternative A, together with Mr. Hayes' amendment in the first paragraph, since he believed it would result, in a fairly short interval, in the amount of credit growth that he thought desirable and would permit the market to lead the System towards the slightly more accommodative stance appropriate for long-term growth. Moreover, it might help to prevent the System from overreacting to the recent change in economic trend, especially if it were to hold bank credit expansion towards the lower end of the staff's projection of 6 to 8 per cent for July-August. If the higher rates were achieved, it would represent a partial return to the inflationary growth rates of last summer.

Mr. Sherrill said the Committee was in a different position from the one it had been in for some time in that immediate technical pressures had eased and therefore there was a better opportunity to consider long-range problems. He thought the

long-range objectives should be to bring inflation to a halt and then rebuild at a sustainable pace. To achieve those objectives, it might be necessary to slow the growth in real GNP to a rate in the neighborhood of 1-1/2 per cent and to permit a rise in the unemployment rate to around 4-1/2 per cent. He believed that it was preferable to reach those targets as quickly as possible and to start rebuilding as soon as possible. In the long run that would be the more effective and less costly approach.

Mr. Sherrill noted that the specifications associated with the two alternative draft directives were relatively close. For example, the projected annual rate of growth in the bank credit proxy during July-August was 6 to 8 per cent under alternative A and 7 to 9 per cent under B, and there was a considerable overlap in the ranges given for the bill rate. Perhaps the most significant difference related to the Federal funds rate, which was specified at 6 per cent under alternative A and 5-3/4 per cent under B. On balance, he would opt for alternative A on the understanding that the Manager would resist any tendency for bill rates to rise above a 5.3 to 5.5 per cent range.

Mr. Brimmer said that, unlike Mr. Hayes, he could accept the staff GNP projection, and, like Mr. Hickman, he was somewhat pessimistic about the economic outlook. He was convinced that the Committee would act too late if it waited for signs of weakness to

appear in the economy. He had expressed the view earlier today that policy could do little to influence third-quarter developments and should therefore be looking ahead to the fourth quarter and to early 1969. He thought it was far better to take gradual steps toward ease now than to have to make a sharp policy change later. With that in mind, he felt the Committee should adopt a policy stance somewhere between alternatives A and B. If necessary, he could vote for alternative B.

He did not think there was much difference between the quantitative variables associated with alternatives A and B in the blue book, Mr. Brimmer continued. For the present he considered it more important to influence market attitudes than to achieve specific quantitative targets. He believed the 3-month bill rate should be allowed to fall below the 5.30 to 5.55 per cent range associated with alternative A in the blue book. An appropriate range for the Federal funds rate was around 5-3/4 per cent rather than 6 per cent. Net borrowed reserves should generally be below $350 million and member bank borrowings should be permitted to decline a little. With respect to prospective growth in bank credit, the differences under the two alternatives in the staff's projected growth rates for July-August were so small as to be unimportant.

As he had observed earlier, Mr. Brimmer felt the Manager had not resisted the recent upcreep in bill rates as vigorously

as was desirable. In that connection he (Mr. Brimmer) had been advocating a reduction in the RP rate to 5-1/2 per cent. That step, he believed, would be consistent with taking the edge off the currently tight policy posture without overdoing it.

Mr. Maisel commented he did not think the choice for today was so difficult. Over the past six months the Committee properly and gradually established a very restrictive monetary policy on the assumption that there would be little or no fiscal restraint. The largest fiscal restraint package in history had just been passed. It did not make sense to him to vote for the same monetary policy after that package had passed as was voted before. A no-change decision today would make superfluous all the Committee had said about the necessary relationship between monetary and fiscal policy.

Mr. Maisel thought the Committee should now move from a monetary policy that remained restrictive even after recent market changes to a neutral one, that is, a policy where the Federal Reserve attempted to achieve a normal growth in deposits and the market determined rates based upon its demand. That was not possible under the blue book policy specifications for alternative A. They were considerably more restrictive than the average for the last half year. In that period, the bank credit proxy grew at an annual rate of 4 per cent and thrift institutions' deposits at

6 per cent. Such a policy was too restrictive both in terms of past relationships and of results. It should not be maintained.

Instead, Mr. Maisel continued, the Committee needed to reformulate the guides for monetary action for the period ahead in light of the restrictive effects of the fiscal package on the economy. Such a reformulation should be the Committee's principal task at the current meeting. The projections in the chart show that was presented to the Committee in late May provided a strong foundation for such a re-appraisal. The actual monetary experience of the past several years provided another.

Without going into all the reasons for choosing any particular longer-run guide--since the debates surrounding the choice of a guide were very familiar by now--Mr. Maisel said he would like to see the Committee adopt now a trend rate of growth in bank credit or in total deposits as a longer-run guide to operations. As a goal for the specific rates of increase, one that would basically make monetary policy neutral in the coming six months, he would suggest that both the credit proxy and total deposits grow around an 8 to 9 per cent annual rate.

Mr. Maisel said he would consider that neutral since historical experience indicated that total loans and investments of banks had expanded at a rate close to 8 per cent and total deposits by more than 9 per cent in the years 1961 through 1964,

when economic growth was non-inflationary in character, and when banks were competing effectively for time and savings deposits.

The choice of an 8 to 9 per cent annual rate for bank credit appeared to Mr. Maisel to be on the conservative side. The late May chart show included an 8-1/2 per cent annual rate of growth in bank credit as consistent with a slowing in economic expansion and an abatement of inflationary pressures, given the current package of fiscal restraint. Since that time, the economy looked weaker than was earlier presumed--with the second quarter 1968 increase in GNP seeming to be nearly one-fourth slower than assumed in the chart show. Monetary constraints were in effect. Unless the Committee returned to a neutral stance, it could not expect an adequate flow of funds even to meet the little or no growth now projected. Housing starts for May, and almost certainly June, were at very low levels. Since the economy was accumulating a large deficit in the housing supply, that would tend to raise rents and housing prices and thus would have a direct inflationary impact on the consumer price index.

Mr. Maisel said he did not mean that the Committee should strive for 8 to 9 per cent growth rates every week or even every month. Clearly, market circumstances, such as Treasury financings, might dictate a higher rate over some periods, and lower over others. And he was not suggesting that 8 to 9 per cent would not

be subject to reevaluation--every time the Committee met--in light of changes in economic and financial conditions. As operations proceeded it might turn out that a somewhat higher, or somewhat lower, rate of growth developed in a way that was consistent with the Committee's goal of continued, but non-inflationary, economic growth.

What short-run operating targets, Mr. Maisel asked, would be consistent with a desired objective of monetary neutrality for the next several months? Clearly, the current operating targets that had evolved out of the last Committee meeting and subsequent market developments must--as the Committee had agreed in the past--be considered restrictive. They were tighter than the January-June average. If the Committee viewed the rates of economic growth for the second half of 1968 presented in the last chart show as reasonable targets, then it would have to move rather promptly to get monetary restraints off the track. If anything, the latest economic outlook suggested that credit demands over the second half might turn out to be less strong than assumed earlier. Thus, monetary policy would have to change in order to attain conditions that would allow sufficient credit expansion so that credit no longer exerted a downward pressure on demand.

Mr. Maisel thought that over the short-run period of the next four weeks, operating targets that would probably have the

highest probability of putting the Committee on the trend line of a desirable longer-run bank credit objective included a Treasury bill rate down in a 5.10 to 5.30 per cent range and a Federal funds rate around, and not infrequently below, the existing discount rate. That might move the proxy slightly over the desired rate in view of the accelerated tax payments that would need to be made and the likelihood that the Treasury would raise a substantial further amount of new cash in August, but the blue book predicted it would not be much. A deviation of credit on the plus side might be consistent with a desired longer-run goal partly because it would reflect only temporary credit demands that were not neutralized by seasonal adjustment factors. Such a change would also be desirable because an increased flow of credit in the short run might be necessary as a force to galvanize borrowers into increasing their spending plans soon enough to avert an overly retarded pace of economic expansion, with associated sluggish credit growth over the longer run. That change could be achieved under a liberal interpretation of alternative B.

In addition, Mr. Maisel believed that the repurchase rate should go down to the discount rate and also it would be useful if the discount rate moved down promptly by 1/4 per cent. A discount move would aid the Committee in achieving normal flows with less need to press open market operations. It would be more efficient to have an immediate small discount change rather than wait a

month or two during which the Committee might well lose the opportunity for more market-attuned smaller movements.

Mr. Daane said he thought the System quite clearly confronted the need to change its policy posture. The only questions at the moment were those of timing and technique.

As to timing, Mr. Daane thought a choice between alternatives A and B involved a close decision. He was mindful of the need to moderate the pace of economic expansion and the need to dampen inflationary expectations. Accordingly, his preference was to wait until the next meeting of the Committee before deciding whether to change policy. However, in the interim period he would resist any further uptick in interest rates and would allow any signs of less pressure on credit markets to show through. Unlike Mr. Kimbrel, he would resolve doubts on the side of ease.

As to techniques, Mr. Daane said he would rely on open market operations and would reserve a discount rate change for later--mid-August at the earliest. For the present, he tended to agree with the view that the Committee should change its policy course gradually. He would accept alternative A and Mr. Hayes' amendment in the first paragraph of the directive.

Mr. Daane indicated he would like to see the RP rate reduced to 5-1/2 per cent. He was not sure, however, that the Desk would have an opportunity to make this reduction in light of the upcoming even keel period.

Mr. Mitchell remarked that today's meeting was highly important in determining the future direction of policy. Many of those sitting around the table would recall the statement once made by Professor Wallich to the effect that the only way to control an inflation was to have a recession. The staff, Mr. Mitchell thought, was now suggesting the possibility of a recession if policy was not eased, and he found himself tending to agree with their analysis. Even so, he could not go along with the strategy implied in the easing alternative B and in particular he did not want to go as far as Mr. Maisel. He (Mr. Mitchell) favored a policy posture close to that advocated by Mr. Brimmer, or somewhere between alternatives A and B.

To give effect to his policy preference, Mr. Mitchell continued, he would reword the primary instruction of alternative A as follows:

"To implement this policy, while taking account of forthcoming Treasury financing activity, System open market operations until the next meeting of the Committee shall be conducted with a view to accommodating the current tendency toward somewhat less firm conditions in the money market that has developed since the preceding meeting of the Committee . . . ."

Such a directive, Mr. Mitchell said, would give appropriate recognition to the less firm money market conditions that had

developed recently. There might be a question as to whether market psychology or System operations had been the primary influence in producing the easier market conditions, but the more important consideration was the fact of the easing itself. He hoped the Desk would continue to do at least as much as it had recently to accommodate the market's easing tendency, and he also hoped that market psychology would continue to develop so that the System would not appear to be leading the market but following interest rates down. In other words, he was not advocating what might be described as an overt move to ease policy, but he did want to exploit market psychology.

With respect to Desk operations, Mr. Mitchell continued, the RP rate should be reduced to 5-1/2 per cent at the first opportunity. A Federal funds rate centering around 5-3/4 per cent would seem appropriate and net borrowed reserves should average around $100 to $200 million.

An appropriate growth rate for the bank credit proxy during July-August was in the 6 to 10 per cent range, Mr. Mitchell thought. He was suggesting a relatively wide range because he felt uncertain about the staff projections. In evaluating the proxy he believed an allowance should be made for acquisitions of Euro-dollars by banks.

Mr. Black reported that Fifth District business activity showed mixed signs over the most recent four-week period. The

Richmond Bank's grass roots contacts suggested that the employment situation had registered further improvement; that prices and wages continued to rise; and that construction activity was still strong. Industry leaders reported some weakening in new orders, backlogs, and shipments, however, and there had been a distinct decline in the state of optimism of both bankers and other types of businessmen.

At the national level, the latest information seemed to provide a good case for at least a probing move away from the recent restrictive posture of monetary policy, Mr. Black thought. In fact, one could argue that the System had already made a couple of gestures in that direction with the recent small adjustment in RP rates and the reduction in net borrowed reserves in the latest statement week. It seemed to him, however, that the market was still awaiting a solid signal that at some early date the Committee would allow the new fiscal measures to relieve monetary policy of some of the burden it had had to bear. Unless the market received such a signal, further reductions in market rates over the next few weeks struck him as doubtful. Yet in the light of the revised second-half estimates, he believed that a further falloff in rates, by perhaps as much as 20 basis points, would be desirable. Moreover, in view of the recent improved tone in the gold markets and the international exchanges, such reductions would appear to involve minimal foreign risks.

Mr. Black believed that for the present any change in policy should be moderate and should be confined to open market operations. He would favor somewhat easier money market conditions, with Federal funds rates fluctuating between 5 and 6 per cent and averaging close to 5-3/4 per cent and with published net borrowed reserve figures closer to the latest statement week's figure than to the levels characteristic of the second quarter. Something might also be gained by returning to the practice of making RP's at the discount rate. Alternative B seemed to conform most closely to that prescription.

Mr. Clay commented that the long-sought fiscal restraint action had been taken, and the situation with which monetary policy had to deal in the months ahead would be altered by that fact. However, it would appear prudent for the System to move cautiously in its adaptation of monetary policy to that action and the economic developments that might flow from it.

Mr. Clay thought that fiscal restraint would have considerable influence on the economy, and the rate of economic growth might slow down significantly. The pattern and timing of those developments were sufficiently unclear that it would appear desirable to await further evidence of the economic situation arising from the fiscal action and other factors before making any marked monetary policy move.

The public economic policy job that needed to be done could not be accomplished without a somewhat slower pace of growth in economic activity, Mr. Clay continued. Expansion of aggregate demand at a pace more nearly in line with the underlying potential of the economy was necessary if the economy was to move toward price stability over time, even though some increase in unemployment would result in the short run. The need for that adjustment had been apparent in the serious cost-push inflation, which still continued to be a problem. It was further underscored by the difficult situation that continued to prevail in this country's foreign trade developments and in its international payments deficit.

Mr. Clay noted that the money and capital markets had shown some response to the Government's fiscal restraint action. That response had been moderate, particularly outside the Government securities market, and it had varied by different types of credit. Yet it had been significant. It was reasonable to expect added market response, quite apart from monetary policy actions, if evidence of a slower pace of economic growth became available.

The Board staff estimated in the blue book, Mr. Clay noted, that under prevailing money market conditions, the member bank credit proxy for July-August combined would rise in a 6 to 8 per cent annual rate range, with August showing a 10 to 12 per cent

increase. Those growth rate estimates were importantly related to United States Treasury financing activities, and their exactness was affected by the limited information available as to the nature and timing of the financing.

Indications of that probable pace of growth in bank credit under prevailing money market conditions suggested to Mr. Clay that the Committee should not undertake open market operations to attain easier money market conditions. In fact, the upper range of the estimated bank credit growth for the two months combined was higher than probably was desirable, and there was risk of an excessive pace of bank credit growth even under prevailing money market conditions.

The draft economic policy directive alternative A appeared to Mr. Clay to be appropriate.

Mr. Scanlon reported that economic activity in the Seventh District continued at a high level, with relatively full utilization of the labor force and continued strong upward pressures on wages and costs. A group of Midwest business economists meeting at the Reserve Bank during the past week had reported that they generally expected the growth of gross national product in the second half of 1968 to be about one-half that in the first half--roughly comparable to the projections made by the Board's staff in May. The business economists expected the recent trend of price

increases to continue unabated. That group believed that capital expenditures would not be a source of economic growth in the second half of 1968 or in early months of 1969.

The major producers of machinery in the District reported that their business had slackened, Mr. Scanlon continued. Farm machinery sales were well below year-ago and dealers were reported to hold large inventories. Construction equipment continued weak in both new orders and shipments. While there were large backlogs of orders placed by electric utilities, the current placement of new orders was below expectations. The large diversified producers of machinery reported that total new bookings in the first half were below the first half of last year and order backlogs had been worked down. These producers did not expect any over-all improvement before 1969.

There were differences of view within the automobile industry, Mr. Scanlon said. The preponderant view was that the recent high sales would continue through the remainder of the year. Third-quarter sales forecasts had been raised. Production runs of some 1968 models had been extended.

The large general-merchandise retailers in the District were fairly optimistic on second half 1968, Mr. Scanlon said. They were projecting sales gains around 6 per cent over year-earlier levels.

Mr. Scanlon commented that agricultural surpluses were rising again. There was little prospect either that grain prices would show much improvement or that expenditures under the Government's agricultural programs would be curtailed in fiscal 1969. The Reserve Bank's current survey of country bankers indicated the demand for agricultural loans, both real estate and non-real estate, continued strong. It indicated also that the rise of farm land prices in the District had continued even though grain prices were relatively low and mortgage credit continued fairly tight.

The demand for housing continued strong in the major District centers, Mr. Scanlon said. There were indications that rental vacancy rates were low; the number of houses available for sale was relatively small; houses sold quickly when offered for sale; and prices continued to rise rapidly. Reflecting that demand situation, permits issued for residential structures in the Chicago area were reported to be continuing the strong trend of the first five months, as was the total value of permits for all construction in the metropolitan area. In the Detroit area, construction activity had been curtailed by a strike of carpenters which began in May and ended only recently. Demand for office space continued strong, with no apparent easing in the pace of new construction in the Chicago area. Some very large new developments of combined

office-commercial-residential facilities were in the planning stage for the near-downtown area.

The mid-year re-investment period experience of savings and loan associations in the Seventh District was generally comparable with that reported in the green book or somewhat better, Mr. Scanlon continued. A spokesman for the Chicago Home Loan Bank expressed the view that the re-investment period had brought no surprises and that lending policy and volume at the associations in the District during the next few months would not be affected one way or the other as a result. Two months or so ago, in the wake of the closing of two Chicago associations, expectations of local association managers were quite pessimistic, but as newspaper publicity on those events died away, the gloom lifted and, apparently, with justification.

Mr. Scanlon also reported that the Chicago downtown banks had recently offered and aggressively promoted 5 per cent open account passbook saving programs. The response had been greater than expected, with the bank lobbies crowded since the new programs were announced. In the two weeks ended July 10, the weekly reporting banks in Chicago reported aggregate declines of $75 million of savings deposits and aggregate increases of $193 million "other" time deposits of individuals, partnerships, and corporations. Of the latter figure, $96 million was negotiable

CD's in denominations of $100,000 or more. The introduction of the so-called "golden passbook" accounts, therefore, appeared to have accounted for a net gain of about $22 million of time and savings deposits for those banks over the mid-year.

Mr. Scanlon commented that the weekly reporting banks in the District had a substantially larger growth of loans in the five weeks ending in June than in the corresponding period last year. While loans on securities showed a sizable increase, against a moderate decline last year, there were significantly larger increases this year in loans to businesses, consumers, and on real estate. Commercial and industrial loans for District banks showed the largest gain in the period in four years, while for the United States the increase was roughly comparable with both 1967 and 1966. Bankers reported the demand for loan commitments had eased, following several months of very strong demand, probably reflecting the enactment of the surtax. The current demand for loans, however, was described as "active."

As to policy, Mr. Scanlon said, if one looked only at the continued strong domestic price pressures and the balance of international payments situation, he would conclude more monetary restraint was needed. If one looked only at the projected abrupt slump in economic growth in the third and fourth quarters, he would suggest a need for at least some monetary expansion,

particularly in view of the lag between monetary policy action and impact on the real economy. But one had to recognize that wage contracts which called for large annual increases for several years limited the effectiveness of current policy in bringing the economy again to the path of stable growth. To achieve conditions which would provide a base for re-establishment of a better balance of supply and demand in labor and other markets was a painful process. In his view, to accomplish that objective, the economy probably would need to undergo a period with virtually no growth of real output. Under those circumstances, unemployment probably would rise moderately but there was real question that the country would be prepared to accept as much unemployment, or for a sufficient period of time, as was needed to produce wage negotiations that would result in stable economic growth. So he believed the greatest contribution the Committee could make was to live with a slower rate of growth at this time and try to hold firm.

Within the framework of the projected economic development described in the green book, Mr. Scanlon had difficulty reconciling the money market conditions and aggregate money, credit, and reserve measures projected in the blue book. It appeared that reducing net borrowed reserves from a range centering on $275 million to one centering on $100 million would have more than negligible effects on credit expansion. The blue book suggested

that that would likely be associated with a shift in bank credit growth from a range of 6 to 8 per cent to one of 7 to 9 per cent. In any event, those were relatively rapid rates of growth considering the general economic goals of moving to re-establish stable economic growth. His staff viewed credit demands, including the projected $3 billion August Treasury financing, as likely to be somewhat weaker than indicated in the blue book, unless there was more expansionary thrust in the economy than was generally projected.

Despite those differences of view, and accepting the blue book projection, Mr. Scanlon favored adoption of alternative A and the amendment to the first paragraph proposed by Mr. Hayes. He hoped that in view of the projection for strong credit demand the Manager would resist any tendency for credit expansion to reach the high end of the projected ranges.

Mr. Scanlon said he would like to see the rate on System RP's at 5-1/2 per cent. He believed the Committee had not experimented sufficiently to know the effect or value of the tool, but this did not appear to him to be the time for further experimentation. Whenever further tests were made, they should be made at the direction of the Committee.

Mr. Galusha reported that this year's Ninth District wheat output was going to exceed last year's record output by

2 per cent, according to the U.S. Department of Agriculture. Wheat prices were at a record low for recent years, reflecting domestic supply conditions and the improved crop prospects throughout the world. Therefore, it was expected that the cash income of District wheat producers would be less this year than it was last year. It was particularly disturbing that production of durum wheat might be 50 per cent greater than it was last year.

Evidently System policy had had an effect on Ninth District country banks, Mr. Galusha continued. The Minneapolis Reserve Bank's July 1 survey of commercial bankers serving agricultural areas indicated that there had been a pervasive increase in loan rates, both on short-term and on long-term loans, and a modest decrease in the availability of funds. Even so, there was only a slight increase between April 1 and July 1 (from 7 to 10 per cent) in the proportion of respondents anticipating difficulties in satisfying expected loan demand, and over all there was no hint of impending crisis in the survey replies. However, farm loan demand was not reported as being particularly strong in the July 1 survey, and one of the explanations frequently given, at least for the relative weakness in demand for long-term loans, was high interest rates.

Turning to Committee policy, Mr. Galusha said he was in favor of a modest--and he stressed the word "modest"--change in

policy before the Treasury announced the terms for its August financing. The domestic economic outlook might be such as to require even lower interest rates than were implied by alternative B, but he would be inclined to go slowly--to change policy modestly now and then again in August or September, unless of course the outlook became sharply more bullish.

Waiting until August or September before making a first move would be unwise, it seemed to Mr. Galusha, both economically and (perhaps more important) politically. It was hard for him to imagine that confidence in the dollar would be greater in a month or two than it was now, and he did not see that because the U.S. balance of payments position was only superficially strong, the Committee should delay changing policy. It was enough for him that, by the test of the market place, there presently was considerable confidence in the dollar. He would take the opportunity afforded to lead world interest rates to more reasonable levels. To argue that the underlying U.S. payments position ruled out any monetary easing now was to argue, he believed, for running a 4-1/2 per cent unemployment rate rather far into the future.

From the discussion today, Mr. Galusha said, it would appear that there was at least a consensus on what passed for the long run in monetary circles, but a real division on timing

of the Committee's response. He believed the Committee had to attempt finer tuning than had been possible the last three years if monetary policy was ever to be used effectively in a full employment economy. Restrictive fiscal measures had been enacted by the Congress and it was necessary to assume the results would be as predicted or the majority of American economists had to be relegated to the role of lobbyists junior grade. And, of course, the Committee had serious time strictures imposed by the Treasury financing. It had an obligation to anticipate the future, for it had only minimal effects on the present, and none on the past. The Committee was experiencing the backwash now of national policies of last year which would run their course regardless of what the Committee did today.

Mr. Galusha said he favored alternative B of the draft directives, but with the emphasis on a modest degree of easing. He would drop the RP rate to the discount rate by the end of next week. He had not made up his mind about the discount rate.

Mr. Swan said that business conditions in the Twelfth District did not seem to be much different from those in the country as a whole. District data indicated that there was only a slight increase in employment in June so that the rate of unemployment probably rose, as it did nationwide. Orders for lumber products were far in excess of production and mill prices

had risen sharply since late June, for reasons that were not entirely clear. Among the explanations given were hedge-buying against the possibility of a lumber strike in British Columbia, heavy buying by defense supply centers, the usual anticipation of vacation shutdowns at the mills, and some replenishment of inventories.

Major District banks had been under somewhat less pressure in recent weeks, Mr. Swan continued. They had decreased their borrowings but had remained substantial purchasers of Federal funds. Both banks and savings and loan associations came through the mid-year interest-crediting period reasonably well.

As to policy, it seemed to Mr. Swan that the immediate domestic and international situations argued against a substantial or overt move toward further ease. In that connection, he thought it was too soon to consider a reduction in the discount rate. On the other hand, he felt it would be most undesirable if there was a reversal of market expectations and interest rates began to move up again. If that happened, counteracting measures should be taken.

To translate that view into a specific policy prescription, Mr. Swan said, he would favor a position somewhere between alternatives A and B even though he recognized the fact that there was not a great deal of difference between the two alternatives.

He felt uncertain as to what relationships were developing between member bank borrowings, net borrowed reserves, and the Federal funds rate, but on balance he preferred a funds rate centering around 5-3/4 per cent rather than 6 per cent. He agreed with those who had suggested the System RP rate should be reduced to 5-1/2 per cent.

With respect to directive language, Mr. Swan said his first inclination had been either to accept alternative A if it was understood that doubts would be resolved on the side of ease, or alternative B if the instruction was changed from "attaining somewhat easier" to "attaining slightly easier" money market conditions. However, he now preferred alternative A with Mr. Mitchell's modifications and he also favored Mr. Hayes' amendment in the first paragraph.

Continuing, Mr. Swan said he had another revision to suggest in the first paragraph which would highlight the fact that recent growth in money supply had been larger than growth in bank credit. The relevant passage might be worded as follows: "Growth in bank credit and time and savings deposits has been moderate on average in recent months; growth in the money supply has been larger as U.S. Government deposits have been reduced."

Mr. Coldwell reported that Eleventh District economic conditions continued to reflect a strong growth position, with

industrial production, employment, and construction all showing sharp advances in the latter part of the second quarter. Industrial production for the State of Texas increased 1.5 per cent in May to a level nearly 11 per cent above the year earlier. Special recent gains occurred in machinery and transportation equipment. Mining activity showed little change, while nondurable goods industries experienced modest improvement. Construction contracts awarded in the five Southwest States touched by the Eleventh District rose sharply in May by 9 per cent over the previous month, and on a cumulative basis were 3.5 per cent ahead of the comparable year-earlier period. Residential construction continued to expand and had been the primary cause of the construction contract award increase during 1968.

Employment activities in the District showed more-than-seasonal improvement during May, Mr. Coldwell said, and unemployment remained at the low level of about 2.5 per cent of the labor force. Total employment was almost 4 per cent ahead of the comparable month a year earlier. Some increase in unemployment due to an influx of teenagers into the labor force occurred during June, but basic labor market conditions remained very tight, and average weekly hours in manufacturing in Texas during May reached 41.9 hours.

Evidence of retail trade activities, Mr. Coldwell noted, seemed to point toward continued strength of consumer spending, as

department store sales in the four weeks ended June 29 were 13 per cent above a year earlier, and cumulative through this period for the year were 12 per cent ahead of the comparable period a year earlier. New automobile registrations in the major Texas markets dropped during May but were well ahead of a year earlier.

Mr. Coldwell said that District agricultural conditions reflected the very wet spring, and the development of major crops, though favorable, seemed to require some dry, open weather. Cotton planting in the District States was estimated at 5,827,000 acres, or 14 per cent above the 1967 acreage. That upturn resulted from less required diversion than in the prior year, a sharp reduction in the payment rate for diversion in excess of the minimum requirement, favorable prices during the past marketing period, and a better planting season. However, cash receipts from farm marketings during the first four months of 1968 were virtually unchanged as crop receipts were down 7 per cent but livestock receipts up 4.5 per cent.

District financial conditions fairly well tracked normal seasonal changes though reflecting the continued pressures on reserve positions, Mr. Coldwell continued. Commercial and industrial loan demand had risen at twice the rate of the comparable year-earlier period during the four weeks ended July 3, but most of the advance was concentrated at the very large banks in the

Dallas and Houston areas. Thus far in 1968, commercial and industrial loans had risen on an unadjusted basis by 9.2 per cent, or more than three times the rate of growth a year earlier, and even more rapidly than in the similar period of 1966. In contrast, however, total investments had declined in recent weeks, and for the year as a whole were down about 4 per cent. Demand deposits of the weekly reporting banks rose sharply during the most recent period, although that advance was colored by efforts to show a favorable call-date picture. Time and savings deposits also advanced, as did large-denomination negotiable certificates, but the rate of advance of total time and savings deposits was well below the year-earlier growth rate. Borrowings from the Federal Reserve Bank had declined sharply, though there appeared to be more banks with special situations and a few which were reaching toward a continuous-borrowing status. Banker attitudes in the District were still quite uneven, with a few large banks under severe pressure, but the majority of country banks, except in the seasonally-demanding agricultural sector, were finding their position quite comfortable.

Turning to the national situation, Mr. Coldwell said he found himself in considerable disagreement with the green book interpretation of prospective economic developments. It seemed to him that there was still no real evidence yet of fiscal

restraint impact on the economy. The green book seemed to place much reliance on the conjecture that consumer buying might fall and that inventory accumulation would shortly be the cause of reduced industrial production. At most one could be certain of some seasonal reductions in auto stocks and, due to a special situation, in steel inventories. He was sure that wage-cost pressures were persisting and were likely to continue for the rest of the year.

Expectations of businessmen might have shifted slightly, Mr. Coldwell said, but his contacts emphasized the overwhelming importance of the wage-cost-profit squeeze and the impact of the tax bite on working capital balances. Reaction so far had not been to change attitudes on capital requirements or labor saving investment but to view the tax as another cost giving rise to additional financing whether by balance withdrawals, bank loans, commercial paper, or capital issues. The construction industry might retrench a while, but demands were so intense that even the high rates were not driving away borrowers.

The green book pessimism was overdone in Mr. Coldwell's opinion, especially regarding the consumer. He felt there was at least an equal chance that the consumer might save less and borrow more to continue his purchases. The higher taxes might impinge upon disposable income in a constant sense, but incomes were

rising so rapidly and prices both now and in the future going up so visibly that the "man on the street" might continue his buying undeterred by the tax increase.

Mr. Coldwell commented that the financial conditions of the near-term future would be heavily influenced by the Treasury financing and by the ramifications of the financing methods corporations selected to meet July 15 tax payments. Some upward Treasury bill rate pressures were visible, as were the beginnings of the seasonal pressures of the fall. Concurrently, he expected even greater loan demands as well as heavy capital issues by corporations and municipalities.

With respect to policy, Mr. Coldwell felt his view of the near-term future left very little room for easing credit. He thought the Committee might stimulate even larger wage demands and perhaps even higher prices if it suggested that credit policy would be eased to accommodate these developments. Moreover, he was concerned with a possible regeneration of short-term investments abroad if U.S. interest rates slipped much below their present levels. Given the country's weak trade position, he wondered if the United States could afford such outflows or a return flow of Euro-dollars to Europe. He believed the country had made real headway in its international posture over the past two months and he would be distressed if a new deterioration were to blunt the progress toward renewed confidence in the dollar.

In summary, Mr. Coldwell said he would counsel the Committee to go slow in easing its present policy posture. Of the two policy alternatives he would obviously select alternative A, with conditions approximating $250 to $400 million net borrowed reserves, 5-1/4 to 5-3/4 per cent 3-month bill rates, 5-7/8 to 6-1/8 per cent Federal funds rates, $500 to $650 million member bank borrowings, and a 4 to 7 per cent growth rate in the credit proxy for July-August. Those were marginally tighter conditions than were spelled out for alternative A in the blue book. They would not place the System in a position of leading interest rates downward but would permit some market easing if that should develop. Similarly, he would counsel against any actions or comments which might lead the market to expect a System position favoring materially lower interest rate levels.

Mr. Latham said there was little to note with respect to trends in the New England economy that was at variance with national trends or those reported at the June 18 meeting. Unemployment insurance data for June suggested that there might be a decline in the unemployment rate of 3.8 per cent which had prevailed in New England since July of 1967. Strike activity continued to have an adverse effect on employment figures. Construction remained at a high level with no signs of a downturn. Durable goods production in May was 6 per cent below the cyclical

peak of January 1967, with particular weakness in the machinery industries. Output in both the electrical and non-electrical machinery industries fell in the three months ended in May after early year improvement. Nondurable goods production was still trending upward with the greatest strength in rubber, chemicals, and shoes. Sharp declines, however, occurred in textiles, paper, and food products.

Mr. Latham noted that Boston mutual savings banks experienced their third consecutive month of net savings outflow in June. Deposit inflows at mutuals outside of Boston were slightly below the gains in May and a year ago. Real estate loan increases at the New England mutuals were about in line with the experience of 1967. Mortgage rates continued to increase.

Final reports for May, Mr. Latham continued, confirmed a slowdown in the rate of cash flows into New England life insurance companies. Increased demand for policy loans was evident as policy loans were up 24 per cent from April and nearly double the increase experienced in May 1967. New mortgage commitments during March, April, and May--while off from the winter months--were still well ahead of the corresponding period of 1967. The larger commercial banks in New England anticipated a continued demand for loans with ample funds available at existing rates.

Mr. Robertson made the following statement:

Like everyone else, I am glad that the overdue fiscal restraint package has been adopted and that monetary policy is no longer having to "go it alone" in controlling inflationary excesses. We can now look forward to a definite cooling off of the domestic economy, moderated not only by the new fiscal measures but also by the cumulative effects of our own monetary restraint and perhaps by a healthy degree of consumer self-restraint as well. Internationally, confidence in the dollar has shown a dramatic resurgence, as both our own actions and the misfortunes of others have underscored the comparative economic and political stability of the United States, and as the latest round of official agreements has served to buttress the international financial mechanism in general. The consequent attraction of capital to the United States has been so great as to be almost embarrassing.

In this environment, the key issue for monetary policy becomes not so much whether, but when we can appropriately move to slack up on credit restraint. This will undoubtedly have to be an exercise in "fine tuning", adapting policy just enough to partially offset the growing effects of restraint from other sources in the interest of avoiding "overkill" and settling down to a steadier and sustainable pace of non-inflationary economic growth.

This is a close question, I believe, but on balance I would resolve it by confirming the more comfortable tone that has emerged in the money and credit markets, without quite yet moving to enhance this easier tone by an overt action to make reserves more abundantly available. Inflation is a powerful and tenacious force once it has achieved a firm grip on an economy. We have only begun to loosen that grip, and I would like to see more corroborating signs of progress in that direction than we have available to us at this moment before I would feel justified in voting for a substantial relaxation of monetary restraint. We still face some upward wage-price pressures in the period just ahead of us; and on the balance of payments front we need to be sure of some basic trade account improvements, and not just capital inflows, before we can consider that we are back on the track that leads to fundamental equilibrium.

I recognize full well that monetary policy, like most other economic influences, has lagged effects on activity, and that therefore we must make our decisions today with an eye to the possible course of events through the fall and into next year. But I am prepared to run the risk of waiting a few weeks longer before acting, in the interest of being surer of the shape of the future with which we are trying to deal. And I feel fairly confident that any significant policy action on our part would still prove timely if it were taken on the far side of the Treasury financing action just ahead of us. The Treasury debt operations will involve us in the usual "even keel" constraints for most of the time between now and the next meeting of the Committee. These financing operations themselves may exert some tightening influences on the market, and I would hope the Manager would resolve doubts on the side of ease in dealing with them. I want to see money and credit markets consistently retain the more comfortable atmosphere that has recently emerged.

Assuming it would be helpful on that score, I would be in favor of moving the rate on repurchase agreements with dealers back down to 5-1/2 per cent at the first opportunity. I do not like to see this or any other Federal Reserve instrument seemingly used to sweeten the Treasury's position, but the proper over-all credit enviroment should be the goal of each of our actions, and the repurchase rate could best serve that goal by getting back to the discount rate as quickly as possible and staying there. I submit that, far from being a technical adjustment void of policy significance as the Manager initially hoped, the RP rate has had clear overtones of policy implications every time it has been changed; and that until we have studied this recent experience much more carefully to be sure such changes can be useful, and until we have developed a clear method for the Committee to guide and direct these changes, I am in favor of no further discretionary RP rate changes at all.

With these general policy objectives in mind, I would favor Mr. Mitchell's proposed revision of alternative A of the current directive. It should be understood that such a directive does not preclude a reduction in the Federal funds rate or relatively shallow net borrowed reserves should this be necessary to keep interest rates from backing up in the days or weeks ahead.

Mr. Robertson added that he could also accept Mr. Hayes' suggestion for inclusion of a statement on wage pressures in the first paragraph of the directive and had no objection to Mr. Swan's proposed rewording of the reference to the money supply.

Chairman Martin observed that today, for the first time in some time, there appeared to be differences of view among Committee members that went beyond mere language preferences for the directive. His own view was that a trend toward easier monetary conditions was inevitable. However, he was not as pessimistic as the staff was concerning prospects for economic activity, given the facts that there had been a year of serious inflation and that fiscal restraint legislation had been enacted at least a year too late.

There was a tendency to get frightened by the spectre of recession when measures were being taken against inflation, Chairman Martin observed. What he was seeking was disinflation and not recession, although he recognized that drawing a line between the two was difficult. As Mr. Sherrill had noted, a firm base had to be established from which stable economic growth could be achieved, and such a stage might be reached this fall. There were, however, international complications that might cause severe problems in the fall, if not before.

In sum, Chairman Martin said, he would like to see lower interest rates eventually. Timing was the critical issue, and

at the moment he did not think there were clear indications of a need for an overt policy move. He felt that at this juncture the System should move toward ease as modestly and gradually as possible. A reduction in the discount rate to 5 per cent might be desirable later but in his judgment it would be premature at present. The System had moved slowly in firming policy on the upswing and should not be too precipitate in moving toward ease now. He was mindful of the fact that the money supply had grown rapidly in the period when the System was trying to exercise restraint and, as other members of the Committee had noted, there had been and continued to be political considerations bearing on monetary policy. It was important for the System to act in a manner demonstrating that it was in control of the situation.

Chairman Martin thought his position was consistent with alternative A as redrafted by Mr. Mitchell. He (Chairman Martin) would not like to see interest rates move back up; he would favor a policy of resisting the crosscurrents working against the natural downward trend in interest rates.

The Chairman then proposed that the Committee vote on a directive consisting of the staff's draft of the first paragraph with the amendments suggested by Messrs. Hayes and Swan, and alternative A of the second paragraph drafts with the modification Mr. Mitchell proposed. It would be understood that such a

directive was intended to call for resisting a back-up in interest rates but not for aggressively seeking to push rates lower at this point.

Mr. Hayes said that while a large number of voting members of the Committee had made rather unqualified statements against further easing during the go-around, Mr. Mitchell's proposed directive language seemed to him clearly to call for a move toward further ease. He would prefer a directive calling for "confirming" or "maintaining" the somewhat less firm conditions that had recently developed.

Mr. Mitchell commented that his intent was not to push interest rates down, although he thought rates were on a declining trend. Rather, it was to accommodate any downdrift in yields caused by market forces in the period ahead, and to resist advances. He did not favor a directive calling for "maintaining" current market conditions, since such language might be interpreted as an instruction to offset any further declines in interest rates.

Mr. Robertson said he would interpret Mr. Mitchell's proposed language in the manner the latter had suggested.

Mr. Daane remarked that he thought the Committee should continue on the policy course it had adopted at the preceding meeting and that Mr. Mitchell's proposed language was consistent with the instructions it had issued at that meeting. In his

judgment the word "accommodating" was more appropriate than "maintaining". He would not be in favor of operations that aggressively sought to achieve greater ease.

Chairman Martin commented that it was important for members not to consider themselves bound by the policy views they had originally expressed in the course of the go-around, but rather to feel free to arrive at final positions on policy in light of the Committee's full discussion.

In response to questions about how he would interpret the proposed directive operationally, Mr. Holmes said he might first review his understanding of the directive issued at the preceding meeting. As he had interpreted that directive, Desk operations were to confirm any downward movement in interest rates--particlarly Treasury bill rates--brought about by market forces following passage of the fiscal restraint legislation, and to cushion any subsequent increases. A range from 5-3/8 to 5-5/8 per cent had been specified for the 3-month bill rate, and through most of the period the 3-month bill had held around the lower end of that range, thereby validating expectations of a decline. Desk operations had been designed to confirm the reaction in market rates that actually occurred. He would interpret the language Mr. Mitchell proposed today in a similar manner--as calling for resisting any back-up in rates but not

offsetting a spontaneous downward movement that developed as a result of market forces. At the same time, no attempt would be made through open market operations to push interest rates down.

In the period ahead, Mr. Holmes continued, Desk operations might aim initially for a Federal funds rate of around 6 per cent. As he had noted earlier today, some shifts had occurred in the relationships among various money market variables and he could not be sure whether a 6 per cent funds rate would be consistent with bill rates close to present levels or somewhat below. If such a Federal funds rate turned out to be associated with a 3-month bill rate above current levels, he would think it appropriate to move the funds rate a shade lower. Moreover, as he had noted earlier, the Desk would resist any uptick in bill rates that might develop from time to time.

In reply to another question, Mr. Holmes said operations along the lines he had indicated might well be associated with wider variations in member bank borrowings and net borrowed reserves. The growth rate of bank credit was also difficult to predict. Possible ranges for these variables might encompass a combination of those specified in the blue book for both alternatives A and B, including outcomes that were at the lower end of the range for one variable and at the higher end for another. In short, he did not believe that firm predictions

could be made about the relationships among these variables in the coming period.

Concerning the rate on System RP's Mr. Holmes noted that there might be an opportunity tomorrow for providing reserves through RP's and, in line with the Committee's discussion, he would propose to set the rate at 5-1/2 per cent. There was a slight risk, he thought, that such a change in the RP rate would be interpreted as more of a policy signal than was intended since it would occur right after a Committee meeting. On the other hand, current reserve projections suggested there might not be another occasion for making RP's before the Treasury financing and a change in the rate during the financing would not seem appropriate.

Chairman Martin then asked if there were any objections to voting on a directive of the type he had suggested earlier.

Mr. Daane said he thought the language of the proposed second paragraph would be improved if the word "current" was deleted from the phrase "with a view to accommodating the current tendency toward somewhat less firm conditions."

There was general agreement with Mr. Daane's suggestion.

> 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 continued to expand rapidly in the second quarter, with inventory accumulation accelerating while the rise in capital outlays and in consumer spending slowed. The new fiscal restraint measures are expected to contribute to a considerable moderation of the rate of advance in aggregate demands. Industrial prices have been increasing less rapidly than earlier, but consumer prices have continued to rise substantially and wage pressures remain strong. Growth in bank credit and time and savings deposits has been moderate on average in recent months; growth in the money supply has been larger as U.S. Government deposits have been reduced. Conditions in money and capital markets have eased somewhat, mainly in response to the increase in fiscal restraint. Although there recently have been large inflows of foreign capital, the U.S. foreign trade balance and underlying payments position continue to be matters of serious concern. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to sustainable economic growth, continued resistance to inflationary pressures, and attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, while taking account of forthcoming Treasury financing activity, System open market operations until the next meeting of the Committee shall be conducted with a view to accommodating the tendency toward somewhat less firm conditions in the money market that has developed since the preceding meeting of the Committee; provided, however, that operations shall be modified, to the extent permitted by Treasury financing, if bank credit appears to be deviating significantly from current projections.

Mr. Hayes commented that, while he had voted in favor of the directive, he had done so reluctantly.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 13, 1968, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary

ATTACHMENT A

July 2, 1968

PROPOSAL FOR U.S. PARTICIPATION IN STERLING BALANCES CREDIT PACKAGE

It is proposed that the Treasury, through the ESF, participate as principal in the arrangement with the BIS; that is, the Treasury would undertake a commitment to make three-month renewable dollar/sterling swaps with the BIS for the U.S. share (approximately $600 million). As outlined in the BIS plan, such swaps could be drawn upon by the BIS--to finance drawdowns of sterling balances--during a three-year period and, after a two-year grace period, would be repayable during a five-year period ending ten years after the initiation of the scheme.

When and to the extent that the swap was drawn upon by the BIS, the dollars would be made available by the ESF. If the resources of the ESF are insufficient to meet these and other commitments, the Federal Reserve would be prepared to warehouse temporarily for the ESF necessary portions of the sterling it acquires as a result of the swap with the BIS.

In view of the principle that the Federal Reserve should confine its foreign operations to short-term maturities, the Treasury will provide assurance to the Federal Reserve of its readiness, upon request, to take back the warehoused sterling within a reasonably short period. In any event, the Treasury will stand ready, upon three months' prior notice, to reacquire each warehoused drawing at any time beginning one year from the date of warehousing. Any rewarehousing of sterling involved in a particular drawing will be at the discretion of the Federal Reserve.

ATTACHMENT B

DRAFT: July 15, 1968

(Draft of proposed letter from Secretary Fowler to Chairman Martin)

Dear Mr. Chairman:

On several occasions in recent months, representatives of the Federal Open Market Committee have discussed with the Treasury the problem that arises when drawings under reciprocal currency arrangements reach maturity without a reversal of the funds covered.

Federal Reserve drawings under its reciprocal credit facilities are made to provide foreign central banks who are unwilling to hold new dollar acquisitions on an uncovered basis with a temporary alternative to holding uncovered dollars on one hand or, on the other, purchasing gold from the United States or requiring the United States to purchase the surplus dollars through recourse to the International Monetary Fund. Drawings have generally been restricted to situations in which there was a reasonable hope for a reversal of the flows of funds so that the Federal Reserve would be able to acquire the necessary foreign exchange to liquidate the commitment in timely fashion. It has always been clearly established policy on both sides that Federal Reserve use of such credit arrangements is appropriate for only limited periods of time; current policy, as generally understood, calls for repayment within one year, if not earlier.

There have been occasions, however, when such reversals did not materialize. On these occasions, arrangements have regularly been made by the System and the Treasury under which the United States used its basic reserve resources of gold, drawings on the International Monetary Fund, and the issuance of Treasury foreign currency-denominated securities to meet the problem which arises when the cover granted by the swap drawing is withdrawn.

Naturally the Federal Reserve wishes to maintain the essentially short-term character of its swap drawings and must always be in a position to honor at maturity any commitments it has undertaken under its reciprocal currency arrangements in cases where flows of funds to its swap partners do not reverse themselves within the appropriate period. Accordingly, the Treasury will stand ready, as in the past, to use the basic reserve resources of the United States to the extent required and in the combination most suited

to the interests of the United States that can be negotiated to obtain and provide to the Federal Reserve the foreign currencies needed.

In light of this understanding, and in view of the fact that swap drawings by the Federal Reserve, while initially conserving the reserves of the United States, may, if not reversible by market forces, necessitate a use of such reserves in connection with the repayment of such drawings, it is appropriate that there should continue to be consultation between the Treasury and the Federal Reserve on the use of swaps. This purpose can no doubt be accomplished through a continuation, and if necessary intensification, of the consultative procedures already developed by representatives of our two agencies concerning use of the swaps.

ATTACHMENT C

July 15, 1968

Drafts of Current Economic Policy Directive for Consideration by the Federal Open Market Committee at its Meeting on July 16, 1968

FIRST PARAGRAPH

The information reviewed at this meeting indicates that over-all economic activity continued to expand rapidly in the second quarter, with inventory accumulation accelerating while the rise in capital outlays and in consumer spending slowed. The new fiscal restraint measures are expected to contribute to a considerable moderation of the rate of advance in aggregate demands. Industrial prices have been increasing less rapidly than earlier, but consumer prices have continued to rise substantially. Growth in bank credit and time and savings deposits has been moderate on average in recent months; the money supply has expanded considerably as U.S. Government deposits have been reduced. Conditions in money and capital markets have eased somewhat, mainly in response to the increase in fiscal restraint. Although there recently have been large inflows of foreign capital, the U.S. foreign trade balance and underlying payments position continue to be matters of serious concern. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to sustainable economic growth, continued resistance to inflationary pressures and attainment of reasonable equilibrium in the country's balance of payments.

SECOND PARAGRAPH

Alternative A

To implement this policy, while taking account of forthcoming Treasury financing activity, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the somewhat less firm conditions in the money market that have developed since the preceding meeting of the Committee; provided, however, that operations shall be modified, to the extent permitted by Treasury financing, if bank credit appears to be deviating significantly from current projections.

Alternative B

To implement this policy, while taking account of forthcoming Treasury financing activity, System open market operations

until the next meeting of the Committee shall be conducted with a view to attaining somewhat easier conditions in the money market; provided, however, that operations shall be modified, to the extent permitted by Treasury financing, if bank credit appears to be deviating significantly from current projections.