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TRADITION AND INNOVATION IN MONETARY MANAGEMENT

Remarks by

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## TRADITION AND INNOVATION IN MONETARY MANAGEMENT.

Undoubtedly, when the history of monetary management in 1966 is written, great stress will be placed on the enormous demands for credit and the rise in interest rates to the highest levels in 40 years. Such an emphasis would not be misplaced. But the more perceptive observers will probably also notice the nature and extent of innovation in the use of monetary policy instruments by the authorities in an effort to meet the heavy responsibilities which confronted them. And perhaps the most perceptive of all observers will notice the most critical aspect of the entire operation: there was a careful blending of tradition with innovation in the execution of monetary policy this year -- as over the whole half century that our central bank has been upon the national financial scene.

If our future historian combs the financial records of the current year even more finely, he cannot miss detecting another -- more disquieting -- under-current of feeling among contemporary observers as the year unfolded. This was the persistence of a fear (sometimes vague, sometimes more pronounced) that a financial panic or monetary crisis was about to occur. There was also a conviction on the part of many that the monetary authorities were out of touch with the money and capital markets, and -- worst of all -- that the Federal Reserve System was perfectly prepared to push its credit restraint policies vigorously -- even to the very edge of a market crisis.

Of course, I may be completely wrong in my speculations about the probable concern of future historians. Yet, as I travel about the country, I hear comments and questions raised by a fairly large number of our own contemporaries which reflect the same mosaic of anxieties about the course of

monetary affairs. In responding, I emphasize that, in my personal judgment, fear of an impending financial crisis (particularly a crisis resulting from the pursuit of monetary policy) was thoroughly unwarranted. Nevertheless, I do recognize that such fears did exist, and the subsequent lessening (at least slightly) of market pressures since late September may not have fully erased them.

Consequently, I think this might be an appropriate time and place to describe carefully the way in which the Federal Reserve System has carried out its responsibilities this year -- and above all to indicate its capacity and determination to make available to the market at any time whatever volume of new bank reserves that may be necessary to forestall a financial panic. Of course, all of this has been said before, but there may be some advantage in repeating it. Furthermore, it may also be worthwhile to undertake a more systematic review of the information system on which monetary management is based. While the general outlines -- and even some details -- of this system are also known, changes have occurred over time and another sketch may prove helpful.

With these objectives in mind, I will:

- Summarize the central strategy of monetary policy during 1966.
- Try to answer the question of whether there was an impending financial crisis during the late Summer.
- Review the intelligence sources of the Federal Open Market Committee, the central stage of monetary management.

### Monetary Management in 1966

As mentioned above, a brief summary of the main developments in monetary policy this year may add perspective to the comments below. It will be recalled that the current policy of credit restraint became explicit in the late Fall

of 1965. After more than four years of monetary and fiscal policy designed explicitly to stimulate economic expansion, it became evident as the year progressed that the fundamental conditions of the economy had changed drastically. Reflecting the policy measures of the previous few years, the economy had moved into the neighborhood of full employment by mid-Summer. Then came the quickening of the military effort in Vietnam, bringing in tandem a sizable draft on the Nation's resources and manpower. From this unfortunate conjuncture of circumstances sprang strong inflationary pressures which are still with us.

To counter these pressures, a policy of monetary restraint was announced explicitly in the first week of December. As the new year progressed, credit tightness also progressed, becoming particularly restrictive during the Summer months. A restrictive fiscal policy was also adopted. But the contribution to restraint of aggregate demand from this source was of a smaller magnitude than that originating with monetary policy. It will be recalled that modest tax increases became effective in late Winter and Spring. These consisted principally<sup>a</sup> of restoration of previous reductions in excise taxes on automobiles and telephone service, and the acceleration of personal and corporate income tax payments. Then, about the first week in September, temporary suspension of the 7 per cent investment tax credit was recommended, and the measure was adopted in October.

This configuration and timing of fiscal action should be kept in mind, because to a considerable extent they conditioned the configuration and timing of monetary management in 1966. In fact, throughout the year, most of us in the Federal Reserve System have been fully conscious of the critical importance of fiscal policy to the success of our own efforts. Regarding my

personal position on the question, I said in mid-July that I felt a general tax increase would have been desirable earlier in the year. I went on to say that, in the absence of such a move -- and in the face of the continued rapid expansion of outlays on plant and equipment and of bank loans to business to help finance these outlays -- I thought it would be helpful to suspend temporarily the investment tax credit. Therefore, I was pleased when this step was taken.

### Conception and Execution of Monetary Policy

This year, probably far more than usual, officials of the Federal Reserve System have tried to explain not only the main objectives of monetary policy -- but also why particular steps were taken. Of course, each speaker has made it clear that the views expressed were his own and not those of the System or its official organs. Here also I wish to stress that the following account is my own, personal interpretation of monetary strategy over the last 12 months.

The prime aim has been to moderate the over-all growth of bank credit. But as the year progressed, a special concern developed with respect to the rapid expansion of bank loans to business. In the first eight months of the year, total bank credit (loans and investments combined) rose at an annual rate of about 8 per cent, compared with 10 per cent in all of 1965. Also in the January-August period, total loans at banks climbed at a 12.5 per cent rate, against 14.7 per cent in 1965 as a whole. But the profile of business loan expansion was sharply different: these loans increased <sup>an annual rate of</sup> at/almost 20 per cent <sup>slightly</sup> during the first eight months of 1966 -- / faster than the rate of expansion registered in all of 1965. Furthermore, during June and July, such loans rose at a 30 per cent annual rate; this was the most rapid two-month expansion in

business loans in

10 years. But these demands on the banks were not singular; businesses were also raising a record volume of funds in the capital markets, and these, too, assisted in financing the further accumulation of inventories and fixed investment.

Yet, despite the desire to moderate the growth of bank credit, a number of serious constraints limited both the pace and degree of restraint which the Federal Reserve System could exert. We were concerned not only with the liquidity position of commercial banks -- but also with the continued orderly functioning of the financial markets and the stability of nonbank financial institutions, particularly mutual savings banks and savings and loan associations. Under the mounting competition among different institutions for funds -- and between all institutions and the market -- the ability of savings intermediaries to cope with a possibly severe loss of deposits became increasingly uncertain. While my own doubts about the prospects for these institutions were apparently never as grave as those evidenced by some other observers, nevertheless, I have felt all along that we could not be insensitive to the situation in which they found themselves.

#### Implementation of Policy

In the last year, as one would naturally expect, we have made use of all of the general credit policy instruments. We have raised the discount rate and reserve requirements on member bank time deposits, and we have made extensive use of open market operations. Moreover, we have given special attention to the administration of the discount window and the effects on the competition for savings of the maximum interest rates payable by member banks on time and savings deposits(governed by the Federal Reserve Board's Regulation Q)

The public announcement of the shift to credit restraint was made last December when the discount rate was raised from 4 to 4½ per cent. Simultaneously, the maximum rates which banks could pay to attract savings were established at 4 per cent for regular savings deposits (so-called passbook accounts) and at 5½ per cent on time deposits. Although I was not a Member of the Federal Reserve Board at the time, it appears from the latter record that the / moves were strongly motivated by a desire to avoid an abrupt impact of the shift to restraint on credit flows. It was known that as credit restraint spread through the financial system, market rates would rise. This uptrend would clearly render uncompetitive the existing 4½ per cent ceiling on time deposits -- particularly on the large-denominated negotiable time CD's at commercial banks. If a heavy attrition in these CD's had occurred as the credit restraint policy got underway, the resulting cutback in the availability of bank credit probably would have exceeded that desired as a policy objective. To avoid this, the decision was made to raise the Regulation Q ceiling. It was also felt that such a move would enhance the ability of the banks to compete for the deposits of business firms and other large holders of liquid balances. This subsidiary objective was certainly implied by the decision to keep the maximum rate on passbook savings at 4 per cent, and thus cushion the effects of the change on S&L's and mutual savings banks. Furthermore, in lifting the rate on time deposits by one full percentage point to 5½ per cent, it was also generally expected that only a few banks at most would actually move to the maximum within the coming year. In other words, it was thought that the ceiling essentially was being put out of reach.

In retrospect, however, it is obvious that such was not the case. As the enormous demand for credit built up during the Spring and Summer, more and more banks began to raise their offering rates on negotiable CD's and to shorten the maturities. By early March, the 5½ per cent maximum was posted by a number of banks, and ultimately it was offered for the minimum 30-day maturities. Moreover, many banks, even some outside the money market centers, discovered in the differential between the passbook and time deposit rate ceilings a gap through which they could greatly enhance their ability to compete for funds. To fill this gap, a wide variety of instruments was fashioned, of which "savings bonds", and "savings certificates" were perhaps the most popular. On all of them, a rate in excess of 4 per cent could be offered. These instruments were aimed squarely at the small savers wherever they could be found. As it developed, they were frequently found on the individual bank's own passbook rolls, from which a fairly large share of the time deposit inflow at banks actually came. However, undoubtedly the banks collectively made substantial net gains in time deposits during the first nine months of the year, and much of their success can be traced to their ability to by-pass the 4 per cent ceiling on passbook savings.

As this competition for funds intensified through the Summer, we took a number of steps to help moderate it. Twice we raised reserve requirements by 1 percentage point on member banks' time deposits over \$5 million. We also restricted the use of multiple maturity certificates of deposits. Finally, we requested authority to set ceilings under Regulation Q on a number of different bases, including size. When this authority was granted by Congress, we promptly set a 5 per cent ceiling on CD's under \$100,000, while leaving the limit

unchanged at  $5\frac{1}{2}$  per cent for those at or above this amount. Other supervisory agencies fixed maximum rates for the institutions under their jurisdiction. However, in reducing the ceiling allowed member banks, we were fully aware that this was by no means an ideal move and that the competition for funds via market instruments could shave much of the benefits to S&L's and mutual savings banks that many observers expected to accrue.

During the Summer, market rates again began to press against the  $5\frac{1}{2}$  per cent ceiling, and the prospect of attrition in bank holdings of CD's reappeared. This time, however, the Regulation Q ceiling was not raised. Instead, it seemed appropriate to allow some attrition to develop and thus re-enforce the effort to moderate the expansion of commercial banks' business loans. This fact has convinced some observers that the most recent approach was inconsistent with that followed last December. Actually no such paradox exists: the need for credit restraint was much greater in the latest period than was the case a year ago. By raising the ceiling earlier -- and not raising it last Summer -- we were pointing our efforts at the same target, that is, a rate of growth of bank credit more in line with the availability of the country's real resources.

After an increase of  $\frac{1}{2}$  per cent to  $4\frac{1}{2}$  per cent last December, the discount rate was not raised again. Undoubtedly, this fact has given rise to more comment (and even criticism) than any other aspect of monetary management this year. In my judgment, an increase in the discount rate at the outset of a policy of credit restraint was desirable. It was needed not only to help moderate the use of the discount window -- but also to signal the basic change in policy direction: In ~~contrast~~, as the year unfolded, virtually all types of

interest rates moved up steadily. During the Spring and Summer, it appeared that the movement in one rate served primarily as a peg on which to hang still another rise. Week-by-week, reference points for the latest advance moved back through the post-World War II period, through the 1930's and finally came to rest in the early years of the 1920's. Obviously, these rising market rates meant falling securities prices and the progressive erosion of capital values.

In these circumstances, it was no longer mainly a question of restoration of the historical relationship between the discount rate and other short-term market rates. Nor was it a matter of employing a traditional central bank instrument in a conventional manner. Rather it was a question of judgment about the net advantages to be gained from an increase in the discount rate compared with the virtually certain boost to market yields -- and probably to the commercial bank prime rate -- that such a move would have stimulated. In my personal judgment, the balance appears to have been on the side of caution.

Having said this, let me also say that I by no means view the discount rate as an obsolete instrument of monetary policy. Far from it. In fact, despite my preference for the cautionary approach described above, there probably were short periods in the current year during which -- if the question of raising the discount rate had been presented, the choice for me would have been quite a close one. At certain times, especially when the benefits to the balance of payments are considered, an increase in the discount rate would have appeared quite an attractive proposition. But, weighing the whole fabric of events during the last 12 months, including the fact that no excessive member bank borrowing has occurred, I am convinced that the course followed was the proper one.

Fear of a Financial Crisis

At this point, let me turn to the question of whether we were on the verge of a financial panic during the late Summer. Personally, I am convinced that such fears did not rest on a careful appraisal of on-going events. But more importantly, I am also thoroughly convinced that, if market pressures had been moving to precipitate a panic situation, the Federal Reserve would not have hesitated to inject whatever amount of bank reserves that may have been required to avoid it. I am certain this would have been done even if it would have necessitated a substantial easing of the general policy of credit restraint for a time.

Of course, no one can deny that market strains were severe at certain times during the Summer, especially in late August and early September, both because of the pressures of current demand for funds and also because of expectations of still worse pressures to come. These pressures were particularly noticeable in the municipal securities markets. Under the combined burdens of new borrowing by state and local governments and of liquidation of sizable holdings by commercial banks and other investors, the carrying capacity of this part of the capital market was sorely tested. Week-by-week during July and August, offerings in the secondary market mounted. A sizable share of these originated with large banks, not necessarily in the money market centers, trying to raise funds to meet loan commitments, especially to business borrowers. Moreover, a number of banks which traditionally had absorbed a fair amount of new municipal issues began increasingly to share their participation in underwriting arrangements.

There is no doubt that in August the volume of offerings, new and seasoned, generated great pressure and great uncertainty in the municipal market. The prices at which these securities traded dropped sharply.

Moreover, holders of large blocks of securities which they wanted to sell at times found bids hard to come by. This was particularly true during the last few days of August.

Thus, while pressures were obviously severe in the municipal securities market, in my judgment the evidence does not add up to a financial crisis. Furthermore, the Federal Reserve was in close and constant touch with the situation. In fact, the System's letter of September 1 to member banks (one of our major policy innovations in a year of innovations) had as one of its clear objectives easing the strains in this sector of the capital market.

In the longer end of the U.S. Government securities market, pressures were also evident, although this sector of the government securities market has historically been quite thin. During August dealers became increasingly reluctant to add securities to their positions even at declining bid prices. Sellers encountered even more difficulty than usual in finding buyers. They had to wait longer, and price discounts were clearly much deeper. But here, too, the market continued to function, even over the tightest period in the bond market in the last few days of August.

In the Treasury bill market, the test came somewhat later -- in September after the Treasury's program for handling Federal agency financing led the market to expect expanded Treasury bill financing. The strains were considerable, but they passed rather quickly. There was heavy pressure in the market for issues floated by a variety of U.S. Government agencies in late August, but the Treasury's program immediately relieved the pressure in this area.

The situation in other sectors of the capital market was also strained, but they also continued to function. The volume of corporate issues reaching the market was exceptionally large, but these were in time distributed, even though at record yields in many cases. Traditionally, participants in corporate underwriting syndicates have displayed a readiness to disband on schedule with only slight reference to short-run market conditions. They continued this pattern of behavior this year. Moreover, many investors (such as life insurance companies and corporate pension funds) obviously found the new high yields extremely attractive. In addition to absorbing a large proportion of the corporate issues placed directly, numerous investment officers went shopping for bargains among the public flotations. Typically, they found them.

The markets for finance company and commercial paper seems to have fared reasonably well. It is true that, as the year progressed, a sizable number of finance companies encountered much more stringent credit rationing at commercial banks. Frequently, they were told to shop for other sources, including the sale of issues in the open market. The commercial paper market also provided a financing avenue for numerous firms which ordinarily would have been accommodated more fully by banks. These sectors of the market showed strains under the weight of additional supplies pressed on them, but they seem to have performed well.

The experiences of securities dealers do not suggest the presence of a financial crisis. It is true that the capital positions of many encountered considerable strain under the impact of falling securities prices. With

interest rates rising steeply, the cost of carrying an inventory became increasingly burdensome. Moreover, dealers undoubtedly found bank lending officers far more reluctant than usual, and many may have entertained serious doubts about the continued availability of their outstanding credit lines. Nevertheless, the hard core of dealers did not simply become brokers -- but remained vital links in the market mechanism.

But let me admit again that the market developments described above do reflect correctly the severe pressures that were generated by the frantic scramble on the part of many borrowers to mobilize funds at a rate far in excess of what could be accommodated -- if the policy of general monetary restraint were not to be abandoned. But, I also say again that this pattern does not add up to a financial panic.

#### Communication and System Contact with Market Developments

To me, it seems surprising that anyone could believe that the Federal Reserve would actually be out of touch with the money and capital markets -- or would run the risk of permitting a financial crisis to develop. Yet, this impression did take root in the minds of a number of market participants and serious observers of the financial scene. Thus, it may be well to review carefully just how the System keeps in touch with the market developments.

The central stage for monetary management is the Federal Open Market Committee (FOMC). This Committee (consisting of the 7 members of the Federal Reserve Board and <sup>5</sup> Presidents of/Federal Reserve Banks, including the one in New York) <sup>or four</sup> meets every three/weeks in Washington to assess economic and financial developments and to provide guidance for the conduct of open market operations. But these FOMC meetings also provide a forum for the coordination of monetary management in general.

In order to formulate policy effectively, the Committee needs a system of economic intelligence that provides a continuing stream of information and analysis on economic and financial developments at home and abroad. The system that has been developed over the years is comprehensive and efficient. It is also highly flexible; it can generate special information to deal with particular problems on very short notice when necessary. It enables the members to follow closely short-run developments in financial markets -- from week to week, day to day, and, when necessary, hour to hour. While this is by no means its major purpose under ordinary circumstances, at times of financial stress it can be an exceedingly important function -- as it was in the latter part of August of this year.

The central listening post is the Trading Desk at the Federal Reserve Bank of New York, located in the heart of the U.S. money market. Under the supervision of an officer of the Committee, the System Account Manager, the Desk's staff talks continually with dealers in government and other securities, bankers, officials of financial agencies of the government, and other important participants in financial markets. Among other information, the Desk gets price quotations, information on trading activity and dealer positions, appraisals of current developments, as well as information on sources and nature

of particular market pressures. The Desk also consults regularly with Treasury Department officials regarding management of its cash balance, investment activity of the trust accounts, and planned financing operations. It keeps continually informed regarding actual and prospective corporate and municipal security issues; and it receives daily information on bank reserves and factors affecting them, member bank borrowings, rates on dealer loans and Federal funds, developments in CD markets, etc.

What the Trading Desk learns is rapidly transmitted to the Committee by several channels at different times of the day. First is the "11 o'clock call," a telephone conference hook-up between officials at the Desk, one of the rotating President-members of the Committee at his Bank, and senior officers of the Board's staff in Washington who are frequently joined by one or more Board members. A designated President-member will participate in the call each day over the period between two meetings of the Committee, with a different one taking part for the next inter-meeting interval.

In the 11 o'clock call, which was initiated in 1954, the Desk reports in concise form the information it has gleaned during the morning and indicates what market operations, if any, it contemplates that day to carry out the instructions given to it by the Committee at the preceding meeting. In the discussion, other participants may contribute information they have obtained independently or may comment on the planned operations. I might note, however, that there is a strong tradition -- shared by individual Committee members participating as well as the staff -- against attempting to impose personal judgments on the Manager; all recognize that the Manager bears the final responsibility for executing the policies laid down by the full Committee and that he must be prepared to defend the actions he takes at the next meeting. Within an hour of the call a staff member at the Board distributes a summary of the information reported and the plan for operations to all principals.

At the end of the day, after the markets have closed, the Trading Desk reports on market conditions and its own operations by phone to a Board staff member in Washington, and the latter distributes the information by memorandum to the Board members and senior staff. The Desk also prepares its own written report, the so-called "daily letter", which is mailed to all Committee members.

This daily information is supplemented by two other regular written reports from the Account Manager to the Committee: a weekly report on financial market conditions and open market operations, and a summary document, covering the whole interval from a meeting through the Wednesday preceding the next one. Finally, on the morning of the FOMC meeting day (a Tuesday) the Account Manager distributes a supplement covering the three remaining business days through the preceding afternoon.

A roughly corresponding system is employed in connection with foreign currency operations. Without going into details, it is sufficient to note that there is also a foreign currency Desk at the New York Reserve Bank, from which information on exchange market conditions and System operations is transmitted daily to the principals; and that the Committee's Special Manager for foreign currency operations files written reports on the same schedule as the domestic Manager.

It is evident that the Committee members are kept closely informed on financial market developments by the two Trading Desks, and they often consult with the Desks outside of the regular channels. But the Desks are by no means the only source of information drawn on. The Board, for example, regularly reviews domestic and international financial market conditions with its staff once each week, and the staff is prepared to report and discuss special

developments at any of the Board's daily meetings. Beyond this, the Committee members draw on their own informal contacts with financial market participants as well as on the press, market letters, and similar sources.

Finally, the Committee capitalizes on the regional structure of the System and the close contacts maintained by the Reserve Banks with financial institutions and other businesses in their individual Districts to generate special data when needed from time to time. This channel was used in May of this year, for example, to get information on the current availability of mortgage funds from the major types of institutional lenders.

#### The Longer-run View

While tracking short-run financial developments is an important, and at times crucial, operation, for effective policy formation the Committee needs a longer-run perspective on events in financial markets and comprehensive information and analyses concerning developments in the economy and in the balance of payments. The Board and Bank staffs provide this intelligence orally and in writing, at meetings and between them.

I might turn first to two written reports distributed by the Board's staff before every meeting. These documents are known colloquially as the "green book" and the "blue book" from the color of their covers. Their formal titles are, respectively, "Current Economic and Financial Conditions," and "Money Market and Reserve Relationships." Each reports and interprets recent developments in its area, by means of text, charts, and statistical tables; and each looks forward to possible or probable future developments. The format of each has evolved over the years, as the staff has found increasingly effective means of transmitting intelligence to the Committee.

The green book is distributed on the Wednesday before the Committee meets, so that the principals may have an opportunity to study it thoroughly. A supplement, including any late information and new interpretations, is distributed two days later.

The main body of the green book is divided into three sections, dealing, respectively, with developments in the nonfinancial area, financial developments, and international events. These materials are developed by the/staff, which includes specialists in each of the subject-matter areas, and are edited by the senior staff. They include thorough, carefully considered treatments of developments in, for example, GNP, employment, prices, industrial production, construction, business inventories, agriculture, and consumer spending; in banking, securities markets, Treasury finance, mortgage markets, and the stock market; and in the U.S. balance of payments and major foreign countries.

These sections, more often than not, are followed by special appendixes dealing with particular subjects or topical events at greater length. And they are preceded by an "outlook" section, providing the senior staff's best judgment about the implications for the future of recent and prospective events in each of a number of broad areas.

On the whole, the green book is a remarkable compendium of fact and interpretation that warrants -- and receives -- careful study by Committee members. Recently the green books, which are turned out every 3 or 4 weeks depending on Committee meeting dates, have run between 50 and 75 pages in length. In contrast, in 1952, when similar written reports by the Board's staff first began to be distributed regularly in advance of the meetings (then of the Executive Committee rather than the full group), they were only about

10 pages in length; and as recently as 2 years ago such reports to the full Committee were running about 30-odd pages. Length alone, of course, is a poor -- and possibly inverse -- index of quality; but in this case the added material has represented added value.

One of the most valuable recent additions has been the outlook material with which the report begins. Interestingly enough, this evolved out of an effort by the Committee to sharpen the focus of its own deliberations. In December, 1964, the Committee agreed to experiment with the following procedure: First, the staff was asked to send to the Committee about a week before each meeting a selected list of the major economic and financial questions that, in its judgment, were of central importance for the determination of monetary policy at the time. Secondly, the staff would then distribute a brief analysis on each topic, marshalling the relevant information from the green book and other sources and giving its interpretation of the significance of its analysis for current policy formation. Finally, the Committee members would be invited to organize their comments at meetings, at least in part, around this list of major topics, with members noting their points of agreement and disagreement with the staff's interpretations.

This procedure was followed for nearly a year. But in October, 1965, the Committee concluded that the results hoped for with respect to its own deliberations had not been achieved. At the same time, the staff analyses on the various questions that had been posed had been found to be of great value as a supplement to the kind of material included in the green book. Accordingly, it was decided that the latter report should be expanded to incorporate similar analyses, and this has been the practice since.

The blue book, on money market conditions and reserve relationships, is a much shorter and more specialized report that is distributed on the Friday morning before the meeting, along with the supplement to the green book. It discusses recent and prospective developments in short-term markets and bank reserve and deposit positions; in connection with the material on prospects, it includes the staff's projections of changes in required reserves, money supply, and bank credit for the coming month on the basis of various possible policy decisions at the meeting.

Like the green book, the blue book also has a long history marked by transformations in form and content. Without detailing the various transformations of this report over the years, I might note that it also assumed its present form in October 1965. And again as the ultimate result of a Committee experiment with its own procedures.

Apart from the green and blue books, and the Managers' reports, the Committee receives "country papers", analyzing economic and financial developments in major foreign countries on a regular schedule. And, finally, it gets special staff memoranda on a broad variety of subjects produced either at the specific request of the full Committee or individual members or at the initiative of the staff. Altogether, a remarkably large volume of written material is supplied to each member before a meeting, to help him reach judgments on the kinds of policy decisions that might be appropriate.

The members also rely heavily on oral briefings and discussions with their staffs. A regular feature of the Board's meeting on the day before the FOMC meeting day is the "economic round-up", in which members of the research staff report orally on recent and prospective developments in their various

areas of specialization, with questions and discussion following. Individual Board members may also meet personally with staff to pursue particular issues in more detail. In the days preceding the meeting, each of the Reserve Bank Presidents and their staffs throughout the country also are making intensive preparations. While the precise scope and content of this preparation will vary from one Reserve Bank to another, depending on the interests of the President and the economic characteristics of his District, the following procedure is fairly typical.

The research staff at the Bank will develop its own analysis of current national economic trends. It will have available the green book summarizing developments as seen by the Board's staff, but it will also draw on independent sources of information. At the same time, the Bank staff will analyze current trends within the confines of the District, giving particular attention to those regional developments that are believed to have special import for the course of national monetary policy. For this purpose the Bank staff will draw on a great variety of regional economic and financial data. In some fields where other sources of information are regarded as deficient, the staff may have initiated special reporting arrangements of its own to keep abreast of significant movements.

Of key importance in the economic intelligence network of the System are the close contacts that Reserve Banks maintain with a broad variety of decision-makers in their business and financial communities, including their own boards of directors. From such contacts they often can distill a sense of changing attitude or intentions before the consequences are reflected in economic statistics. This kind of information is especially valuable because of the significant time lags between monetary policy actions and their effects on the economy.

Usually this information is assembled and digested in a series of meetings of the President with his staff advisers. These meetings often will involve one or more lengthy and wide-ranging discussions in the week preceding the FOMC meeting, followed by more specific discussions of desirable policy actions on the day or the evening before the President sits down with his colleagues to deliberate and vote.

#### The Federal Reserve Assistance to the Market

The foregoing comments should have demonstrated that the System is able to keep in touch not only with financial markets -- but with basic economic developments as well. Yet, one may still ask whether the System was fully prepared to forestall a financial crisis. Ultimately, the answer to this question must be provided in the published Annual Reports of the FOMC and the Federal Reserve Board covering 1966. But one can infer a great deal from the steps taken at various times during the year. Some of these (such as the moves to moderate competition for savings) have already been described. But one action was designed explicitly to ease market pressures which developed in August and September.

This action centered in the System's letter of September 1 to member banks. The System's determination to allow a continued orderly (though moderate) growth in bank credit was made unmistakable. At the same time, the need to moderate the expansion of business loans was stressed, and banks were cautioned concerning the market pressures created by the heavy liquidation of municipal securities. Finally, a modified approach to the administration of the discount window was outlined. Banks were told that, while their Reserve Banks would continue to assist them as usual in meeting seasonal or emergency needs for

funds, they would also keep in mind the extent of the borrowing bank's efforts to moderate the growth of business loans, in adapting to any shrinkages in their in their source of funds.

The September 1 approach, as one would naturally expect, was not prepared in a vacuum. During August, literally hundreds of contacts occurred between System officials and participants on the financial scene. These contacts were personal as well as via mail, telegraph and the telephone. Moreover, the traffic was not one way: System people (at the Board as well as the Reserve Banks) themselves originated much of it in a continuing effort to keep in touch with market developments.

The System's concern has not lapsed in the meantime. The Federal Reserve Bank's experiences in the administration of the discount window as outlined in the letter are followed in a systematic way. Immediately after the letter was mailed, a System-wide weekly telephone conference of Federal Reserve Bank discount officers and Board staff was instituted. This was designed primarily to ensure as much uniformity as possible in the interpretation of the objectives sought. While there has been no insistence on adherence to every detail, an effort has been made to see that differences in basic policy are minimized. As experience accumulated, the conference has been called at two-week intervals. In the process, this has turned out to be a highly valuable means of exchanging information about a number of credit policy developments -- well beyond the special questions raised by the discount administration program.

Now I do not wish to claim that the approach outlined in the September 1 letter was the key factor underlying the easing of market pressures in September. Other factors (particularly the re-appearance of the prospect of additional fiscal restraint) may have played a far more important role. Nevertheless, this reassurance that the System was prepared to come to the market's assistance was undoubtedly helpful.

## The Outlook

While the main objective here has been to review some of the key features of monetary management during the current year, perhaps a few observations on the short-term outlook may not be out of order. Over the last few months, the expansion of bank credit has flattened out. This may be partly a reflection of the high level of borrowing early in the year (some of which was undoubtedly anticipatory) as well as the change in the pattern of business borrowing to settle tax liabilities. But given the degree of monetary restraint exerted since last December, I am personally convinced that a significant effect has been registered on the demand for credit. Yet, the over-all demand still for funds is/strong and will probably remain so for some time. On the other hand, I personally doubt that there will be an early return to the frantic business loan pace of/growth experienced until recently (or perhaps I should say that I hope we will not). The atmosphere in the securities markets is also much quieter than it was over the Summer. Although the volume of market flotations remains large, and yields continue exceptionally high, the capital markets are functioning rather well.

In the meantime, considerable attention is being given to the shaping of the proper course for monetary and fiscal policy in the year ahead. However, let me say immediately that I do not wish to use this forum to add my voice to the mounting debate over what national economic policy should be for 1967. Naturally, as a Member of the Federal Reserve Board, I am making every effort to keep abreast of economic developments, and I obviously have an interest in the formulation and execution of a policy possessing an optimum combination of fiscal and monetary measures. However, official machinery does

exist for the evolution of such a policy -- machinery that involves consultation and coordination among the key policy-making agencies in the Administration (e.g., the Council of Economic Advisers, the Treasury Department and the Bureau of the Budget). Appropriately, the Federal Reserve Board participates in this process at both the official and staff level. Moreover, this exchange of views is not confined to a few formally called and carefully planned interagency meetings. Rather, there is a more or less continuous dialogue, much of it informal. Given these opportunities, I am confident that our views will be carefully considered.