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 on Tuesday, July 31, 1962, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Bryan
Mr. Deming
Mr. Ellis
Mr. Fulton
Mr. King
Mr. Mills
Mr. Mitchell
Mr. Robertson
Mr. Shepardson

Messrs. Bopp, Scanlon, and Irons, Alternate Members of the Federal Open Market Committee

Mr. Swan, President of the Federal Reserve Bank of San Francisco

Mr. Young, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Brandt, Garvy, Hickman, Holland, and Parsons, Associate Economists
Mr. Stone, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Cardon, Legislative Counsel, Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Katz, Associate Adviser, Division of International Finance, Board of Governors
Mr. Knipe, Consultant to the Chairman, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Heflin and Francis, First Vice Presidents of the Federal Reserve Banks of Richmond and St. Louis, respectively
Messrs. Sanford, Eastburn, Ratchford, Baughman, Jones, Tow, Coldwell, and Einzig, Vice Presidents of the Federal Reserve Banks of New York, Philadelphia, Richmond, Chicago St. Louis, Kansas City, Dallas, and San Francisco, respectively
Mr. Eisenmenger, Acting Director of Research, Federal Reserve Bank of Boston
Mr. Cooper, Manager, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on June 21 (telephone conference) and July 10, 1962, were approved.

Before this meeting there had been distributed to the members of the Committee a report on open market operations in United States Government securities covering the period July 10 through July 25, 1962, and a supplementary report covering the period July 26 through July 30, 1962. Copies of both reports have been placed in the files of the Committee.

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

The money market has been generally firm since the last meeting of the Committee. Federal funds have traded for the most part at 2-3/4 - 3 per cent, while rates on three-month bills have been in the general range of 2-7/8 - 3 per cent. Free reserve statistics, meanwhile, have fluctuated widely, owing in good part to the erratic and unpredictable behavior of float. All the past patterns from which we draw our daily estimates of float of course reflect the operation of the entire network of airlines, and with a major air carrier

such as Eastern out of operation, the predictive value of those past patterns is seriously impaired--a fact, however, that seems to be well understood by the market, which has not been misled by the higher free reserve figures that have appeared.

An atmosphere of marked uncertainty developed in the market for fixed income securities during the recent period. Questions were raised as to whether and at what rate the balance of payments and the gold situation are improving; as to where the domestic economy is headed; as to whether credit policy might give greater emphasis to the balance of payments; and as to whether this would be true if the economy should slide into recession. Questions were also raised as to the size of the budgetary deficit if we do not have a tax cut; and if we do; and how, in either case, the deficit might be financed. On all of these questions, and on their implications for rate levels, the market found it inordinately difficult to reach a consensus. And with the uncertainties connected with the Treasury financing superimposed on those already enumerated, trading activity slowed down perceptibly as the financing approached.

It was in such an atmosphere that the Treasury selected and announced the terms of its financing operation, which, it is hoped, will activate existing accumulations of funds and galvanize the market into a more spirited pace of activity. The financing operation was generally regarded by the market as an imaginative and constructive piece of debt management, particularly in its effort to reach out for a part of the supply of savings. Early indications suggest a successful operation, especially in the case of the two shorter issues. At the close of trading yesterday, market guesses as to the allotment percentage for the 3-1/2 per cent certificates were in the neighborhood of 15-20 per cent and for the 4 per cent bonds around 35-40 per cent. Guesses on the amount of subscriptions for the 4-1/4 per cent bonds are particularly uncertain, but range from $400 million up to $750 million.

Since the Treasury will raise up to $1-1/4 billion new money in this operation, it is not anticipated that any further cash borrowing will be necessary until the latter part of September--apart, of course, from the $600 million likely to be raised over the next few weeks until the regular bill cycle is rounded out in late August. Other things being equal, of course, the rounding out of that cycle, and the consequent absence of continuous additions to the supply of bills, may well bring renewed downward pressures on bill rates.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities during the period July 10 through July 30, 1962, were approved, ratified, and confirmed.

Mr. Noyes presented the following statement with respect to economic developments:

The tri-weekly cycle of Committee meetings means that it is sometimes too soon to estimate accurately what has transpired in the month just completed, while what happened in the month before seems almost irrelevant to problems at hand. That is the case today.

We now have quite a few figures for June that were not available at the time of the last meeting, but they have been so widely discussed that it is needless to review them in detail. In order to put what I shall say about developments since then in proper perspective, however, it should be said that they were preponderantly bearish. Most impressive, perhaps, was the significant further decline in manufacturers' new orders for durable goods. But average hours worked at factories also declined, and unemployment edged up slightly. Retail sales were down and so were housing starts. Manufacturers' sales were off significantly, and the stock market was down sharply. Moreover, even the series that were up showed less gain than in earlier months. This was true, for example, of production, personal income, and payroll employment.

Taken altogether, the June data not only confirmed that at mid-year the economy had fallen far short of the optimistic forecasts but raised serious question as to the sustainability of present rates of activity.

From what we know, it appears that there had been some improvement in July. It is expected that unemployment may be down a tenth of a per cent, and retail sales will probably be up a little. Common stock prices were also up from the June low. With auto production back to normal, there is a chance that the production index may show a gain, but this is far from a certainty.

These scraps of information are fragmentary--and obviously not well balanced, but taken together with developments in the credit markets, they suggest to me that it is unlikely that the economy moved decisively in July, one way or the other. Nor does it seem probable that expectational data collected in July will provide strong evidence on either side. We know nothing yet

about the results of the survey conducted for us by the Bureau of the Census, but consumer buying expectations, as reported by Sindlinger on a weekly basis, generally declined from late May through June, and then picked up a little in July. Taken literally, however, they indicate, even after the pickup, a lower level of consumer durable goods purchases in the second half of the year than in the first.

The preliminary tabulations of the capital appropriations survey of the National Industrial Conference Board seem equally inconclusive. There was a sizeable decline in such appropriations by durable goods manufacturers, offset in part by an increase in nondurable lines.

The most likely prospect seems to be for a further period of uncertainty, extending for some weeks, or perhaps even months. Such a prospect is, of course, far from satisfactory. The possibility of the resumption of vigorous expansion and any substantial inroad into the present levels of unemployment and unutilized capacity seems very remote indeed. At the same time the danger of a precipitous decline does not seem great. Moderate inventory positions generally, and the special situation in steel, will operate to maintain production in the period just ahead. Consumers' financial condition is relatively strong. Despite widespread expressions of concern, there is, as yet, no hard evidence of weakness in real estate markets. In fact, field reports generally suggest that the reduced volume of single family homes being offered by builders this season is moving fairly well. There are reports of considerable concessions being offered to fill new rental units, but these are usually followed shortly by reports that they have accomplished their purpose.

At a time like this it is important to be sure that the uncertainty is really in the economy and is not in the observer's mind. I have pushed both the data and my mind pretty hard for the last week or so, and I am convinced, on the one hand, that a major downturn is a risk that still lies ahead; and on the other, that there is no assurance that activity will rise, or even be well maintained over the next few months.

Thus, an appropriate monetary policy would seem to be one which recognizes that the possibility of vigorous expansion is practically nil, but that the range within which activity may fall short of it is fairly wide.

Mr. Katz presented the following statement with respect to the United States balance of payments and related matters:

July has been marked by substantial foreign gold purchases. For the month they total about $350 million compared with net foreign purchases of $370 million for the first half of 1962.

The rather optimistic preliminary figures for the second quarter balance of payments have not been borne out. The over-all deficit for that quarter is now estimated at an annual rate of $900 million, or about half the first quarter rate. The outlook for the third quarter, based on 3-1/2 weeks of July, is for a deficit at least as large as in the second quarter whereas earlier some had hoped that payments might have come close to balance. It is difficult to judge the third quarter payments picture because the second quarter figures benefited from the deterioration of the Canadian position and the July figures were affected by the recent improvement.

It now looks as though the Canadian exchange crisis is in the process of unwinding. Funds are moving into Canada in sustained volume and official reserve accruals during July may amount to as much as $300 million. Shifts in commercial payments (the so-called "leads and lags") in favor of Canada make up the bulk of the inflow but some funds have moved into Canadian short-term securities, especially finance company paper, which has been yielding 3.60-3.65 per cent on a fully-hedged basis.

The tightening of credit conditions in Canada has undoubtedly contributed to the capital inflow. The chartered banks, near their minimum reserve ratios, have had to borrow recently from the Bank of Canada and have been large sellers of Government securities. As a result, Canadian interest rates remain high and yesterday a 12-month bill was offered at 5.69 per cent. Because of credit conditions at home, Canadians are now looking for long-term funds in this country and several issues, comprising a sizeable volume of flotations, are currently being discussed.

The London gold market was unusually active in July and official support was indeed heavy, reflected in part in our July gold losses. On Thursday and Friday, July 12-13, and again on July 19-20, the market was particularly active, but it has been quiet since President Kennedy's telecast to Europe on July 23.

These private gold purchases in mid-July coincided with general talk about the U. S. dollar in all European centers. The European financial press had articles about whether the U. S. would raise the price of gold and whether the U. S. dollar was overvalued. Professor Haberler contributed to the debate a statement in Frankfurt that the U. S. dollar was overvalued by 10 per cent.

You had a kind of irresistible force--that is, market views that the price of gold or the value of the U. S. dollar might be

altered--meeting an immovable object--that is, the official determination everywhere to maintain the present gold-price and exchange-rate structure. In fact, Mr. Jacobsson of the International Monetary Fund made the point on "Meet the Press" that was also made by Dr. Wolf of the Bundesbank in a speech in Cologne that the United States wouldn't be allowed to devalue, even if it wished, because "other countries would devalue at the same rate as the dollar so the relative position would not be changed to any important degree."

The U. S. dollar accruals which several European central banks obtained during the past three weeks were mopped up, either through transactions with the Fund, through debt prepayments, or through utilization of Treasury or System holdings of foreign currencies. Special Treasury operations reduced excess Swiss and Dutch dollar holdings. The two large surplus countries--France and Italy--made large debt prepayments.

Over the past week, the dollar's position has improved a little in European centers and only France and Italy continue significant reserve accruals. We have been unable to confirm the French Finance Minister's alleged statement in Washington two weeks ago that future inflows of dollars would not be used to buy gold. However, it is reasonable to expect at least some additional prepayments of the nearly $1 billion of French debt still outstanding to this country.

Last Friday, the United Kingdom repaid the remaining $512 million of last year's drawing in various currencies. The Fund granted the British a $1 billion one-year standby credit.

The experience of the past month suggests, in retrospect, that the network of Treasury and central bank financial agreements now in effect has contributed to allaying uneasiness and speculation in foreign exchange and gold markets. However, as the recent figures indicate, the United States is continuing with a serious balance of payments problem and further tests of this mechanism are surely ahead.

Reports on his talks in Europe from Mr. Hersey, of the Board's staff, who is currently visiting central banks in key Continental countries, indicate that the European business expansion is maintaining a strong momentum although the pace of advance is slower than earlier. In the first half of 1962, output rose more than 3 per cent in both France and Germany. With domestic demand and output continuing to expand in all the Common Market countries, Mr. Hersey expresses the view that Continental Europe is going to be staying at full employment without serious disturbance one way or the other as far ahead as one can look at this time.

In response to a question with respect to U. S. gold losses during July, Mr. Sanford said that through the 25th of the month there had been a decline in the gold stock of $227 million. There would be a further decline reported for the week ending tomorrow.

Mr. Holland presented the following statement with respect to credit developments:

> Applicable as the adjective "uncertain" is to the economic situation, it fits equally well the atmosphere to the credit markets during most of the period since the last meeting of this Committee. Further indications of sluggishness in the pace of economic expansion and press reports of improvement in our basic balance of payments position might ordinarily have been expected to induce some declines in interest rates. These factors, however, have been roughly counterbalanced by continued general firmness in the money market, by discussions of a possible shift to less monetary ease and a more expansionary fiscal policy, and by persistent rumors of dollar weakness abroad.
>
> The ebb and flow of market pressures have been outlined in the report of the Manager of the Account. The overriding sense of these July market movements was that of a cresting of the wave of reactions in investor attitudes to the speculations as to changed Government policies which had become so prevalent around midyear. As is so often true of financial markets, changed dealer and investor expectations as to market prospects led to price and yield adjustments which ran ahead of any changes in the basic elements of market supply and demand. Now, with the flush of attitudinal responses seemingly spent, analysts can approach the tedious task of scanning the available evidence for signs of the effects of changed policies upon the underlying financial flows. Such an effort is essential to the continuing adaptation of policy, but it is never easy, and the circumstances of the current moment are not particularly helpful in this respect. Let me focus the remainder of my remarks on this question, concentrating upon the banking sector in which the first and most significant effects of changed monetary policy upon actual credit flows are likely to be apparent.
>
> Reported bank figures make it fairly clear that aggregate bank credit, seasonally adjusted, will show a substantial decline in the month of July, perhaps in the neighborhood of

$1-1/2 billion. If so, this would be the largest decline since July 1958 and one of the few interruptions in the rising trend of bank credit totals since that time. But a number of special considerations reduce the significance of this bald fact. First, and foremost, Treasury cash financing during July was much smaller than is usual for the month, thus tending to reduce both outright bank acquisitions of Governments and the temporary financing of other subscribers. Securities loans for all purposes declined sharply, with the reduced positions of Government dealers and possibly also some persisting effects of the stock market break being contributing factors. Business loan demand has been generally flat, aside from tax date influences.

On the other hand, it should be pointed out that the lack of Treasury financing or strong loan demand does not need to preclude net bank credit expansion if sufficient reserve ease is present. Banks can simply acquire assets from the market as they did, for example, in similar circumstances in July a year ago. In the current month, banks continued to show substantial additions to their real estate loans and to their holdings of other securities, chiefly agency issues. Continued attention to the banks' rate of acquisition of these more discretionary types of earning assets may give some confirming clues as to the degree of marginal credit availability prevailing within the banking system.

With aggregate bank earning assets shrinking unseasonally, total bank deposits were also down during July. That contraction, however, consisted primarily of a large drop in Government deposits from their high midyear level. Aggregate time and savings deposit growth continued, but apparently at a slower pace in July. The private money supply, sustained by the shifts from Government to private deposits and the reduced drain into time accounts, continued little changed from the second half of June. Thus, the money supply continued on the rough plateau it has traced since late last year, following the sizable demand deposit increases of last fall. Depositors continued gradually to step up their rate of use of demand balances, with demand deposit turnover increasing moderately further outside New York City during June. The total of liquid assets in public hands has continued to grow moderately and somewhat unevenly, but there have been some changes in the composition of such growth, with money supply little changed, smaller additions to deposit-type claims, and a jump in liquid Government securities holdings.

Aggregate reserves available to support private deposits moved upward during the first three reserve weeks in July, reflecting both expected and unexpected additions of reserves

from market factors, heavy System securities purchases followed by midmonth sales, and also member bank borrowings at times to supplement the reserves supplied by market factors and System open market operations. In the latest reported week of July 25, however, aggregate required reserves behind private deposits turned downward again, dropping nearly $90 million below the standard projected in the staff memorandum.

These reserve movements took place in an environment of free reserves averaging $450 million since the last meeting of the Committee. Sizable week-to-week fluctuations and erratic distribution of such reserves, however, often resulted in considerably less easy market conditions than might normally be associated with this level. There was a tendency for bank borrowing to rise when average free reserves dipped below $400 million, a clue that at such levels banks were not always finding the market availability of reserves equal to their desires.

Present projections suggest the current reserve week may again see free reserves in the neighborhood of $350 million or lower, in the absence of further System operations, despite an average $310 million addition to reserves from open market operations already conducted. Operations of the same general order of magnitude may be called for next week in order to offset the drain of reserves from market factors, chiefly vault cash and currency. The degree to which banks press to meet any of these reserve needs not supplied by System operations may give us some further clues as to the impingement of somewhat reduced marginal reserve availability upon over-all credit availability.

Pending the accumulation of this and other confirming evidence, a judicious observer would be justified in withholding judgment as to the trends in the bank credit base of the credit pyramid which are developing in the altered policy environment. A bold observer, though, could point out that the early signs are consistent with a modest dampening of bank credit expansion.

In reply to a question from Mr. Balderston as to how an even keel policy for the next three weeks might be defined in view of the recent fluctuations in free reserves and even in bill rates, Mr. Holland suggested that the term "even keel" would have to be applied in a broad and flexible sense. The Account Manager would need latitude to make interpretations on the basis of interest rates and feel of the market as

well as the free reserve level. Free reserve figures themselves had been particularly unreliable as a measure of reserve pressures in past weeks, and they were not likely to be much more dependable as an indicator in the period immediately ahead.

Mr. Hayes presented the following statement of his views with respect to the economic situation and monetary policy:

> There is not much doubt that the pace of business expansion slowed down during June, and there has been a widespread tendency to point to these June statistics as a forerunner of a major turn in the business cycle. However, if we consider the important contribution made to this "pause" by special factors in the steel and auto industries, the June development becomes somewhat less disturbing than it would otherwise be. Such July data as are available seem to be midly encouraging but are much too fragmentary to permit any valid conclusions. We might characterize business as being generally quite good, with no convincing evidence of any imminent downturn, but also with no forces in sight--apart from the possibility of a tax cut--to give the economy a significant new push upward. It is disturbing that so little progress has been made in closing the gap between available resources of labor and plant capacity and their utilization--although, of course, there is a favorable "other side of the coin" in the continuing improvement in productivity that has contributed importantly to the marked price stability of the last few years.
>
> Turning to the credit picture, including partial July figures, together with complete statistics for June, we get an over-all impression of a fairly vigorous expansion of bank credit. The performance of business loans has been only about "average" in comparison with other recent years, whereas real estate loans have continued their sharp expansion. Bank liquidity dropped off a little in New York this month, but it remains at a very satisfactory level both here and in other parts of the country. As for nonbank liquidity, while the money supply proper has grown by about 2 per cent in twelve months--with most of this gain confined to the second half of 1961--time deposits and other liquid assets have been growing at a strong pace. In fact, the rather sharp rise in total liquid assets during recent months--both absolutely and in relation to GNP--has been unusual for an upward phase of the economy. The country's liquidity seems ample. Granted that

more liquidity will be needed over the longer run to support further business expansion, the risks at the moment seem to be more in the direction of excessive liquidity, which has tended to have an adverse balance of payments effect.

The balance of payments and the international position of the dollar continue to give cause for serious concern. This remains true in spite of the marked improvement in the gold and exchange markets since the President's comments a few days ago, and despite a somewhat improved statistical showing in the second quarter balance of payments figures as compared with the first quarter. With respect to the latter, it is unfortunate that the revised figures are so much less favorable than the preliminary estimates, which received a fair degree of publicity. Also, the market is well aware of the important part played by Canada's difficulties in permitting the good second quarter showing in this country's accounts. The second quarter improvement seems pretty mediocre if we allow for this factor. It is widely recognized that during the present month and quarter, Canadian developments will undoubtedly have a reverse influence, thus becoming an important unfavorable factor in our balance of payments; and the important offset provided by the large debt prepayments by France and Italy tends to be viewed as a "one shot" phenomenon that should not be given too much weight. It is disturbing to note that so far in July we appear to have lost gold and dollars on balance in spite of the large French and Italian debt prepayments.

Although the trade balance has behaved very well to date, it seems unlikely to improve and in fact may deteriorate slightly during the rest of the year. Short-term capital movements have been rather small lately, but unfortunately there has been no real return of such funds to this country. At the same time, longer term capital flows remain a significant unfavorable element in the current balance of payments picture, with a growing tendency to arrange for foreign borrowing in this market. In particular we can look for heavy Canadian borrowing in the current quarter.

It seems clear that the "margin of safety" in our gold stock is being reduced to a rather dangerous level. The gold outflow of the last two or three months can hardly be considered unreasonable in view of our balance of payments deficit position and the already large holdings of dollars by foreigners, yet the French taking of $112 million in particular gave rise to a good deal of nervous comment, and such comment is bound to recur as we get closer to or below the $16 billion mark. I do not wish to minimize the excellent measures that have been

taken to improve our balance of payments situation, especially on the military side; but in view of some probable future shrinkage in the trade surplus, and perhaps some tendency toward greater long-term capital outflows, the net improvement in 1962 in what might be called the "basic" deficit will probably be negligible. The question may well be raised whether the time is not close at hand, therefore, for additional decisive steps, including some in the area of monetary policy, to ward off a full-fledged exchange crisis. The matter of timing may take on added importance when we recollect that nervousness with respect to the dollar and other currencies frequently flares up in the weeks preceding the annual meeting of the International Bank and International Monetary Fund.

The outlook for the Federal budget also carries puzzling and difficult implications for monetary policy. It is now generally admitted that a sizeable deficit is in prospect for fiscal 1963, in the magnitude of at least $5 billion and possibly considerably more, even in the absence of any pending or new legislation affecting the budget. Bearing in mind that a tax reduction within the next few months appears to be a very real possibility, we may soon be confronted with the prospect of an aggregate deficit somewhere near the magnitude of that of fiscal 1959. I am sure this Committee is well aware of the disturbing psychological effects that might develop both here and abroad if this were to happen. Of course, these effects might be greatly mitigated if the type of tax cut involved was generally expected to bring a rapid upsurge in revenues. Also, the situation could be greatly helped if the reduction were accompanied by a freeze on additional expenditures--or perhaps even some cutback--and if the Administration were to announce its determination to finance as much of the deficit as possible out of savings. All of this suggests that the interest rate structure may be subjected to significant upward pressures in the coming months, and of course expectations may accelerate the appearance of such tendencies. The question we may soon face is whether we should support such an upward rate adjustment or perhaps even anticipate it with a signal designed to stress our determination to defend the position of the dollar. At such time we shall of course have to give due consideration to domestic as well as international factors.

It seems to me that we should welcome the Treasury's refunding program, with its frank recognition that long-term issues should have some place in the financing of the current year's sizeable deficit. The refunding operation does, of course, point to the desirability of our encouraging as much stability in the money and capital markets as possible during the next few weeks.

With respect to policy, there would seem to be no need to depart, within the next three weeks, from our current policy of moderate ease. I think the minor modification that took place in our policy six weeks ago was amply justified and worked out very satisfactorily--and I would hope that the consistently firmer tone in the money market that has prevailed, apart from a few unavoidable temporary lapses attributable to erratic market factors, would be continued in the coming three weeks. Specifically, I would hope that both the 90-day bill rate and the Federal funds rate would hold in a range close to 3 per cent, with whatever free reserve levels this may involve. Thus the objective would be to preserve the general feel of the market that has prevailed in the past three weeks. Perhaps the violent and unpredictable swings in market factors in the last few weeks have done us a service in getting the market more used to fluctuations in free reserves that carry no policy implications.

I would think that no change is called for at this time in the discount rate, although I believe it is quite probable that we shall be confronted with the need to give serious consideration to the discount rate within the next couple of months.

As for the directive, I see no need for a change, except that the reference to "the unsettlement of financial markets" might now appropriately be omitted, together with the phrase in the second paragraph "to the extent consistent with the behavior of capital markets."

> Secretary's Note: The suggestions made by Mr. Hayes contemplated the following changes in the policy directive:

It is the current policy of the Federal Open Market Committee to permit the supply of bank credit and money to increase further, but at the same time to avoid redundant bank reserves that would encourage capital outflows internationally. This policy takes into account, on the one hand, the gradualness of recent advance in economic activity~~,~~ AND the availability of resources to permit further advance in activity~~, and the unsettlement of financial markets~~. On the other hand, it gives recognition to the bank credit expansion over the past year and to the role of capital flows in the country's adverse balance of payments.

To implement this policy, operations for the System Open Market Account during the next three weeks shall~~, to the extent consistent with the behavior of financial markets,~~ be conducted with a view to providing moderate reserve expansion in the banking system and to fostering a moderately firm tone in money markets.

Mr. Ellis reported that although New England economic indicators continued to register gains in the month of June, they fell short of expectations based on seasonal patterns. Manufacturing and nonmanufacturing employment showed a slight decline from May on a seasonally adjusted basis, and the change in unemployment also was less than seasonal. Consumer income continued to rise through June, if one could rely on income tax payments as evidence, and consumer spending remained firm as far as could be judged. Cool summer weather was affecting resort areas, and those who depended heavily on Canadian dollars complained that the discount had affected their business.

District reporting banks continued to receive new time money at a fast clip. The banks continued to build up their investments in State and local government securities while running down their holdings of U. S. Government securities with maturities exceeding 12 months. Loan demands remained strong.

As to policy, Mr. Ellis said he was in close agreement with the analysis and prescription presented by Mr. Hayes. It seemed to him that in the period since the preceding Committee meeting an easy availability of reserves had been maintained, with the short-term bill rate generally in the 2.90 - 3 per cent range. Excessive apprehension that the Federal Reserve was moving abruptly toward tightness had been avoided. A continuation of recent policy seemed appropriate for the next three weeks, especially in view of the current Treasury refinancing.

Mr. Ellis also said that he would not change the discount rate at this time. As to the policy directive, he had studied the two phrases suggested by Mr. Hayes for possible deletion, starting with the thought that they should be dropped, and he would concur in their delection if that was the majority view. Someone closer to the financial markets could perhaps make a better judgment as to whether they were sufficiently settled so that the language in question could appropriately be stricken. If such a conclusion seemed justified, he would go along with the suggested changes.

Mr. Irons commented that there seemed to have been relatively little change in either the Eleventh District or the national economic picture. No very good or reliable District data for July were yet available. In any event, however, the current Treasury refinancing would appear to preclude any significant change in the policy that the Committee had been following for the past several weeks. Accordingly, he would come out with the view that the status quo should be maintained as closely as possible, with no appreciable change in Federal Reserve actions that influence the market. By the time of the Committee meeting on August 21 the Treasury financing would be completed, and there might be economic and financial statistics at hand that would be more meaningful than those presently available.

Mr. Swan reported that Twelfth District department store sales held up fairly well in June and the first couple of weeks of July. Auto

sales recovered somewhat in June after a sharp dip in May, and defense-related employment continued to rise in June. The over-all rate of unemployment in the Pacific Coast States, seasonally adjusted, rose rather sharply in June, but this had to be related to the secondary effects of labor disputes in construction along with a delay in the usual seasonal rise in food processing. Another major labor market area in Southern California had been reclassified from substantial to moderate unemployment, this change undoubtedly being related to employment in defense industries. In general, the District picture was not greatly different from what had been reported previously. It showed some strength, but the over-all situation was rather mixed.

There was an increase in loans at District weekly reporting banks in the three weeks ended July 18 compared with a decline for all weekly reporting banks; the District increase was again heavily concentrated in real estate loans. The larger banks continued in a rather tight position in July. They were rather substantial purchasers of Federal funds during the four weeks ended July 25, and they were expected to be net buyers again this week.

Turning to policy, Mr. Swan commented that in view of the Treasury refinancing, the uncertainty as to business activity--with increasing indications that the top of the cycle might not be far away--and the lack of any marked change in the international situation, it was his conclusion that certainly no less ease was in order at this time. He would be satisfied with a continuation of approximately the same conditions that had

existed since around the 18th of July. It would be desirable, in his opinion, for the 90-day bill rate to be at 2.90 per cent or somewhat below, but not higher; and for Federal funds to trade at 2-3/4 per cent, rising to 3 per cent only occasionally. As far as it could be pinned down, he would favor a free reserve position above $400 million. In summary, he would continue about the situation that had prevailed recently but resolve doubts, if any, on the side of ease. He would not change the discount rate at this time. As to the policy directive, he felt rather strongly that the language mentioned by Mr. Hayes should be eliminated.

Mr. Deming reported that although little information was yet available for July, in general the Ninth District seemed to show no appreciable change from what had been happening earlier this year. Nonagricultural employment was up as compared with June 1961, along with manufacturing employment. Minnesota figures for July were up seasonally; data on nonagricultural employment looked a little better against the previous year than the June data. The agricultural situation continued to look good, particularly against last year; wheat production would be up, according to July estimates, 37 per cent from 1961. Farm cash income for this crop year should be better than last year. Retail sales showed no particular signs of strength, with the lengthy newspaper strike in Minneapolis apparently having some effect. Income figures in June were a little higher relative to June 1961 than for the nation as a whole, but in general the Ninth District was just about in line with the country on the income side.

Loan demand at country banks continued to be about as strong as it had been all year. At city banks, loan demand likewise continued to show through mid-July about the same strength as earlier in the year, but in the next two weeks it was off somewhat. This tendency had been observed in other years at about this time, and whether a change in trend or just a pause was involved could not yet be told. Deposit growth was much above the national rate.

Turning to policy, Mr. Deming expressed satisfaction with what had been done in the period since the preceding Committee meeting. He would not like to see conditions easier than at present or to err on the side of ease. However, he would prefer a bill rate of 2.90 to a rate of 3 per cent, with Federal funds at 2-3/4 per cent about half the time and 3 per cent about half the time. There seemed little purpose in talking about free reserves in view of the difficulties of estimating that had prevailed for some time and apparently were likely to continue.

As to the policy directive, Mr. Deming said that he did not like to take issue with those who were closer to financial markets. However, it did seem to him that there was still unsettlement in financial markets, speaking in a broad sense. Hence, he would prefer to leave in the directive the language mentioned by Mr. Hayes. He would not change the discount rate at this time.

Mr. Scanlon commented that the Seventh District economic picture was quite similar to the picture that Mr. Noyes had described nationally.

As to policy, he would recommend maintenance of an even keel, defined in the manner stated earlier by Mr. Holland in response to Mr. Balderston's question. He would not change the discount rate, but he would agree with the changes in the policy directive suggested by Mr. Hayes.

Mr. Tow commented that Tenth District member banks had increased their loan portfolios this year more than in any recent year. At the smaller country member banks, the comparison with previous years appeared even stronger than at the weekly reporting banks, but at both groups the loan expansion had been unusually large.

The gain in real estate credits undoubtedly resulted mainly from efforts of banks to increase current income. On the other hand, the substantial increase in loans to business and nonbank financial institutions, and the rapid increase in consumer and other loans, pointed to the fact that loan demands had been relatively strong.

It might appear that the strength in loan demands in the Tenth District stood in sharp contrast with developments nationally, where loan demands had not shown unusual strength. However, if one considered the markedly different behavior of loan portfolios in weekly reporting banks and in all other banks in the United States, the behavior of Tenth District bank loans appeared less unique. Total loans (other than loans to banks) increased $2.7 billion at all commercial banks in the United States during the first half of 1962. The weekly reporting bank group contributed $0.4 billion; the remaining $2.3 billion took place at other commercial banks.

This evidence of marked divergence in the strength of credit demands at large and small banks presumably had its origin in the characteristics of the current economic advance. While the economic expansion had been relatively moderate, weakness had been most prominent in the demand for durable goods. Credit demands of durable goods producers typically are expressed at relatively large banks, and this would seem to account for the weak performance of loans at the weekly reporting banks. This also would be consistent with loan developments in the Tenth District, which does not have any great concentration of durable goods industries.

These commercial bank loan developments, Mr. Tow noted, appeared to indicate that the funds supplied by the Committee's expansive credit policy had met a responsive loan demand at banks outside the weekly reporting bank group.

Mr. Heflin reported that record or near-record levels of general business activity, tempered by some hesitations and uncertainties, had characterized recent economic developments in the Fifth District. Nonfarm employment increased very slightly in June, but bank debits and factory man-hours declined. Textile man-hours remained close to their May peak, and cotton consumption during the first half of the year was 9 per cent above 1961, but the latest evidence pointed to recent declines in orders and prices. A sharp rise in furniture store sales in June and a successful summer market in the second week of July provided new support for the District's prosperous furniture industry. Insured unemployment increased

a little more than usual early in July. Department store sales rose substantially more than seasonally in the first two weeks of July after having declined quite sharply in June.

The Reserve Bank's latest survey of District businessmen and bankers showed a small improvement in general business sentiment for the first time since February. Manufacturers of nondurables included in this panel reported on balance small gains in employment and hours. But manufacturers generally indicated substantial declines in new orders and backlogs, a tendency toward larger inventories, a few instances of higher wages, and some price declines. The upward trend in real estate loans of District banks that began in April had accelerated markedly in the past three weeks.

Mr. Mills expressed the opinion that the policy objectives set at the preceding meeting of the Committee should be continued, with the drift of the effects allowed, where possible, to maintain a steadily firm interest rate structure. There was the possibility, he noted, that if what amounted to a status quo in policy were continued too long the System would run into the same kind of problem that in his opinion it suffered from earlier this year. If the financial and business community became accustomed to an unchanging policy, it would be disturbed by any mild change that was subsequently made.

In rationalizing the justification for a continuation of present policy, it occurred to Mr. Mills that there were two elements deserving

particular attention. First, increasing symptoms were appearing of a deterioration in Western European economic conditions, with the possibility that a turning point had already been reached that would not become tangibly distinct for some time to come. Against such a change in the economic climate abroad, and pending its aftermath of effects, there were good and substantial reasons for maintaining a firm interest rate structure for balance of payments purposes and, as Mr. Hayes had indicated, in order to be prepared alertly and promptly to meet a crisis condition with conventional monetary policy antidotes should the necessity arise in the next month or two.

The second key element that deserved the Committee's attention, Mr. Mills said, went back to a suspicion that deterioration in the domestic economy was inducing a contraction in bank loans which, if it continued, would create downward pressure on the money supply. It seemed to him that the money supply probably required increasing investigation on the part of the Committee, not with a view to attempting to force an increase but simply to maintain at best the present level. If there was a contraction in bank loans, this objective would require placing sufficient reserves at the disposal of the commercial banking system to encourage and permit the banks to replace losses in bank loans with investments, particularly in U. S. Government securities. If there was substance to that reasoning, a free reserve level of $350 million could be assumed to be sufficient, but free reserves should not be allowed to drop below that particular figure.

Mr. Mills went on to comment that the privilege given to commercial banks to acquire Treasury bonds on tax and loan account in connection with the current refinancing would seem to have been a wise measure. The commercial banks had been given the means of either underwriting the bond issues or, if bonds were retained, giving support to the money supply through the credit-granting process. This was a vehicle that offered temptations for the future, although it could be abused if it were granted too frequently and the banks were allowed to overload themselves with longer term U. S. Government securities. If the economy was in fact moving downward and was going to move downward further, while at the same time it was desirable to maintain the money supply, the over-all effect of that kind of situation might well be--over a continued period of time--to overliquify the banking system, with the risk that this would come into full perspective only at a time of revival when there were inflationary pressures with which to contend. Should such developments come to pass, and if the banks held a substantial but not unreasonable load of U. S. Government securities, a restrictive monetary policy would have the automatic effect of forcing a depreciation in investment portfolios that would aid and abet that policy.

Mr. Mills noted that what he had just said was in the nature of a digression. Returning to the subject of the moment, he would favor a continuation of the policy objectives set at the July 10 Committee meeting.

Mr. Robertson presented the following statement:

I think it is imperative for monetary policy to recognize the deteriorating prospects for domestic economic activity. An increasing number of observers are flatly forecasting an early recession, and most of the others are talking plateau or a marked slowdown of expansion. These changed views are based on fact, not fiction. A growing list of "bear signals" are being given by indicators that have forecast declines in general activity in the past. They include the persistent decline in new ordering and commitments by businessmen, the sluggishness in employment and the length of the work week, the drop in corporate profits, and the slowdown in consumer spending. The leveling off of such broad indicators of economic well-being as our industrial production index and personal incomes are signs of a tired economy.

Signs of economic fatigue are also appearing in the financial area. Most dramatic has been the break in stock prices, but there has also been weakness in business borrowing, the most dynamic element in bank loan portfolios, and in new capital financing. The money supply, the keystone of our liquidity structure, has shown no sustained growth since last fall and has been particularly flat since May.

Moreover, there are increasing signs that monetary policy not only is not providing the stimulus to the economy that it can and should currently, but also that it has been less helpful than it should have been for some months. Thus far in 1962, total bank credit, seasonally adjusted, has not increased even as much as the growth in time and savings deposits alone. True, some of this growth in time deposits has represented a shift from previously idle demand balances, but some of it surely has represented real savings, either new savings or a shift from other savings media.

Hence much of the bank credit expansion we have experienced thus far this year has been the investment of savings rather than the creation of new dollars. If one makes the reasonable assumption that half of the time deposit growth was a diversion of funds that might otherwise have been invested directly in securities or placed in nonbank financial institutions, bank credit expansion reflecting new money creation has been very moderate in 1962, not much greater than in the comparable period of 1959 when we had a restrictive monetary policy, when labor and plant capacity were more fully utilized, and when many observers still thought that further price inflation was a real possibility.

Turning to the immediate situation, I am deeply disturbed by the most recent bank reserve developments. Since the last meeting of the Committee, free reserves have averaged about $450 million, $90 million higher than the $350 million average the three preceding weeks, and correspondingly higher than what I understood to be the

wishes of the majority of the Committee. Nonetheless we dropped $88 million below our reserve provision guideline during late July. Since the change in monetary policy in mid-June, required reserves behind private deposits have actually declined on a seasonally adjusted basis rather than showing a moderate rate of expansion as called for in the current directive. Yet in the face of these developments we seem to be dropping back down to a free reserve figure perhaps below $350 million again this week. (It is interesting to note that if vault cash were not counted as reserves, as was the case in comparable periods of previous cycles, this figure would be much lower, perhaps even a negative figure.)

The accumulation of evidence is suggesting that the recent shift in policy toward less monetary ease, undertaken in the hope that higher interest rates might help internationally, is generating contractive reserve pressures at home. This, I think, is a clear case of incurring a cost that is real for a benefit that is illusory. I have seen no evidence of beneficial effects of higher money rates upon our international gold and dollar flows that would justify the domestic hazards we are running with such a policy.

I, for one, want to be recorded as favoring a policy that seeks to encourage further expansion in reserves, credit, and money even if it means less firm money market conditions and somewhat lower interest rates. This means, to me, that it is high time we retraced our steps, returning at least to the degree of reserve availability existing prior to mid-June. More specifically, I would aim at a free reserve figure between $450 and $550 million and would seek to provide sufficient reserves to the banking system to support some increase in bank demand deposits over and above whatever growth continues in time and savings deposits.

Market confidence, both at home and abroad, is a problem, but the confidence that is pre-eminently needed is confidence in a growing, prosperous, and internationally competitive U. S. economy. Current monetary policy needs to be adapted to this longer range objective and not merely to be utilized as a palliative to passing rumors and market fears.

Our leadership in the free world will not be enhanced by Government economic and financial policies that add to the deflationary forces that are building up all around us. Who here or abroad is willing to see a domestic recession develop on the risk--the very great risk, in my view--that slightly lessened availability of credit and liquidity and slightly higher interest rates will materially benefit our balance of payments problem and yet will not dampen our domestic economy? We should realize that the risk involved in trying in this way to attain, by monetary

> policy action, a remedy for our international financial problems, a remedy that is by no means of certain or significant effectiveness--a remedy that will become increasingly difficult to prescribe as the market forces of declining economic activity and reduced credit demands tend to widen the gap between interest rates in a lagging economy at home and booming economies abroad--is too great a risk to run.

Mr. Shepardson commented that certainly the economy did not appear to be in an exuberant condition. There was doubt as to how far and how fast the economy was going to move in the immediate future. On the other hand, he believed that the factors principally affecting the growth and direction of the economy were outside the impact of monetary policy. He had not seen any indication or heard any comments that would suggest a lack of available funds to meet all of the credit demands that could be generated. To the contrary, most of the comments he had heard recently from bankers and men associated with other financial institutions were to the effect that they were looking for uses of funds. Personally, he did not agree with the thought that monetary policy could materially stimulate the situation. Instead, the solution seemed to lie in other areas. For that reason, he would concur in the kind of policy outlined by Mr. Hayes.

Mr. King stated that he would continue present policy and maintain an even keel as nearly as possible. In view of the Account Manager's comments about market conditions, he did not think it would be particularly desirable to delete from the policy directive the language mentioned by Mr. Hayes.

Mr. Mitchell presented the following statement:

The economy continues to drift along in a lack-lustre fashion. More and more economists and observers are saying publicly that the upswing has ended or is ending or will shortly end. The Ways and Means Committee is holding hearings to find out if the best informed opinion believes a tax cut is needed to reinvigorate the economy. Uncertainty as to the final demands by consumers, patently well founded in the recent behavior of retail sales, is atrophying business spending for plant, equipment, and inventories. The odds are long and lengthening against the probability that the economy will advance vigorously in the last half of the year. It may still be an even bet that it could bump along for another quarter or two at about present levels. The major factor of reassurance on this score is that in several respects the technical position of the domestic economy is good: inventories are low relative to sales, manufacturing conditions are good, capacity utilization is below optimal levels, and we have survived the worst effects of the stock market revaluation.

The major disturbance in the current situation with which we are concerned is the imbalance in the money and capital markets that has been created by our efforts to use monetary policy to deal with the balance of payments situation. The Fed and the Treasury have created a highly artificial situation in the money and capital markets by holding up the short-term money rate through debt management and monetary policy. We have encouraged expectations that long-term rates would rise, and have induced a rise of some 20 basis points, in the face of a preponderance of historical and analytical evidence that long-term rates have passed their sustainable peak.

How long can we artifically sustain a rate pattern of this sort in a faltering economy? European advice and example is not very helpful. The American System is not like that of Western Europe, where the private sector is much smaller and is in significant part dominated by cartels and agreements. The Europeans plan, in the socialistic sense, a great deal more than we do. Their money and capital markets are not only small or nonexistent, they are often under direct control by governments or financial agreements that would be illegal in the United States.

We should be letting our domestic economy use our free markets for money and capital at prices fixed by supply and demand forces unconditioned by the expectations that the Fed and the Treasury are going to hold up rates according to a private Swiss banker's prescription. The issue of overriding importance is the continued strength of internal demand. This

> Committee should recognize the seriousness of the threat to the domestic economy by supplying reserves somewhat more freely, making it clear that there is no possibility of a discount rate increase under current conditions and being prepared to see the short-term rate decline by as much as 1/2 per cent.

Mr. Fulton characterized Fourth District business conditions as rather mixed. Declines in some areas had moderated, but the steel areas had not shown any marked improvement. Department store sales recovered slowly in July from the sharp decline in June, although in the latest week they headed downward again. Sales thus far this year were 3 per cent ahead of last year, compared with a 6 per cent gain nationally. Unemployment increased slightly more than usual for the July period of vacation closedowns and seasonal slowdown in auto manufacturing. Auto sales had been very good recently.

Mr. Fulton then commented on a meeting last week of 21 Fourth District business economists, stating that their conclusions seemed to parellel some of the comments made around the table today. With respect to industrial production, the median forecast was 117 for the fourth quarter of this year, 116 for the first quarter of 1963, and the same figure for the second quarter. The economists based their conclusions somewhat on the pattern of manufacturers' new orders, so some decline in economic activity was foreseen over the next year. Comments were made to the effect that a recession, if it was substantial, would have its foundation in several happenings, including the stock market break, the lack of full use of plant and equipment, and the fact that customers

appeared to be adopting a policy of holding low inventories and expecting immediate deliveries.

All in all, Mr. Fulton said, the outlook was not buoyant. On the other hand, so far as monetary policy was concerned, some of the factors that seemed to indicate a recession to the business economists seemed to him to call for a continuation of present policy. He did not feel that monetary policy could change the factor of psychology on which the economists put considerable store. The Federal Reserve had supplied substantial amounts or reserves to the banking system, but those reserves had been used only sparingly so far as business loans were concerned. Accordingly, he would favor continuing the present level of reserve availability. In his opinion, free reserves of around $350 million would be appropriate and in line with expectations of the business community. He would not change the discount rate at this time. As to the policy directive, since he was not sure that financial markets had stabilized, he felt that the wording of the directive might well be left unchanged.

Mr. Bopp commented that an evaluation of the trend of the Third District economy, like an evaluation of the trend of the national economy, was now a problem of weighing small and conflicting changes. There was the additional difficulty, of course, that District figures were not as recent as those for the nation. Taken individually, each of the latest changes could be explained away as an unimportant jiggle in the statistics, yet put together they indicated that the expansion may have stalled.

The condition of the labor force was not improving, the manufacturing workweek declined in May, and manufacturing output apparently decreased in June. The help wanted index for Philadelphia reached a high point in March and now stood several points below its peak; in the past this index had been a fairly reliable leading indicator. Department stores, however, enjoyed good business in July after a lull in June.

The effects of somewhat less easy money had been reflected in District banking data. Both loans and investments had declined at reporting banks. Deposits, while increasing at country banks, had declined somewhat at reserve city banks. Borrowing from the Reserve Bank and in the Federal funds market had been somewhat greater.

Mr. Bopp went on to comment that while the current Treasury financing operation precluded any significant change in policy at this time, other considerations also suggested a posture of watchful waiting. Whether a recession had begun, was imminent, or was some way off, the fact remained that the economy was operating at much less than optimum levels. Economic information for July and August might well turn out to be no clearer than at present, but it could help in indicating the domestic significance of any moves the Committee might consider making. As for the external problem, it would be important to see whether the recent improvement in psychology proved to be lasting. And finally, it would be necessary to observe the effects of the Treasury offering of longer term issues and to consider further the role that fiscal and debt management policies might play in coming months.

In short, Mr. Bopp said, he would continue policy essentially unchanged, with reserve availability and market rates at about present levels. He would continue the existing discount rate and change the directive as indicated by Mr. Hayes.

Mr. Bryan said that in reviewing the most recent data on the Sixth District he found only three items of any significance that were not available at the time of the preceding Committee meeting. Department store sales were up in July, but this merely cancelled out the decline in June. Insured unemployment was up, along with bank loans.

After stating that he would not change the discount rate at this time, Mr. Bryan turned to the policy directive and said he would leave it unchanged for the reasons stated previously by others. He found himself in a position of agreement with present policy, but only because he did not believe that any tightness existed. Rather, as he read the reserve figures, monetary policy had been fairly easy. Like Messrs. Robertson and Mitchell, he believed that the overriding consideration was the condition of the domestic economy. He would protest strongly if he felt that monetary policy actually was tight.

Mr. Francis reported that Eighth District business activity had continued to show mixed trends. While employment in major labor markets rose more than seasonally from May to June, unemployment also increased. The industrial use of electric power continued to rise. Department store sales declined in June, but apparently picked up in July. Bank debits,

which had shown strength in the first five months of the year, were down in June. Business loans rose sharply from May to June, but they were little changed through the first three weeks of July, an increase in St. Louis being offset by decreases elsewhere. Deposits at District banks rose from May to the third week of July. Agricultural conditions were generally favorable.

Mr. Balderston noted that a continuation of current policy for at least the next two weeks was indicated because of the Treasury financing. It was his feeling that the System had gained some ground from the fact that bill rates had varied moderately and the free reserve figure--due to uncontrollable forces--also had varied. Bill rate developments tended to counteract the view existing in some circles that the System, in cooperation with the Treasury, was exercising sufficient control to peg the rate. While he could not be sure what would happen to the bill rate later in the fall, he was impressed by the thought that deceleration in the rate of inventory building, combined with the change in regulations relating to allowable depreciation, would probably generate a strong corporate demand for bills, thus exerting downward pressure on the bill rate. As to the directive, he had sympathy with the suggestions made by Mr. Hayes because he felt that allusions to market disorders ought to be confined to periods of great turbulence.

Chairman Martin commented that in his opinion a situation of easy money existed. He would be in complete agreement with the point of view expressed by Messrs. Robertson and Mitchell if he thought that any further

easing would help the economy at the present time. Instead, however, he felt that such action would do harm to the economy.

The Chairman also commented that he had checked as carefully as he could on the real estate situation around the country. At times in the past he had noted a contraction in real estate values following a stock market break. However, he could detect at present no decline in real estate values of any significance. Wherever he had tapped sources of information on mortgage funds, he had heard that such funds were pressing on the market for investment.

In his opinion, Chairman Martin said, this was the kind of situation in which easy money could compound difficulties. He did not think that the situation could be corrected by undergirding weak loan standards or inducing people to borrow money if they did not believe they could make a profit on it.

Turning to a summary of today's meeting, Chairman Martin said it appeared to him that with two dissents (Messrs. Robertson and Mitchell) the Committee was in favor of maintaining the status quo in terms of policy. In his opinion, the status quo ought to be maintained, certainly, during the period of Treasury financing, which would run through the August 15 payment date. The next meeting of the Committee, he noted, would be held on August 21.

Chairman Martin next turned to the policy directive and commented that once again a problem of words seemed to be involved. He would not

have any particular objection to the changes suggested by Mr. Hayes. However, he thought a majority of the Committee probably would feel that a decision to maintain the status quo applied also to the language of the directive.

The Chairman then suggested that there be an expression as to the number of Committee members who would favor maintenance of the status quo in terms of the wording of the directive as well as policy. Obviously he added, no particular free reserve target was going to add much to the definition of status quo under present conditions. In general, however, he would propose to ascertain how many members of the Committee would like to follow a policy of status quo--or even keel--during the next three weeks and to retain the existing directive.

Mr. Hayes suggested that the questions be separated. There appeared to be relatively little difference of opinion within the Committee on the question of a policy of maintaining the status quo. However, there seemed to be more difference of opinion as to whether the changes that had been proposed in the wording of the directive should or should not be adopted.

Chairman Martin indicated that he had no objection to proceeding in such manner. Accordingly, he called for a poll of the Committee on the question of maintaining a policy position of status quo for the next three weeks.

This poll revealed that all of the Committee members except Messrs. Robertson and Mitchell favored maintaining the status quo during the next

three weeks. Mr. Robertson qualified his dissent by saying that he would not want to interfere with the Treasury financing and therefore would not object to maintaining a status quo, or even keel, during the period of such financing. Subject to that qualification, however, he would vote against the policy expressed in the current economic policy directive.

The positions of the Committee members on policy for the next three weeks thus having been ascertained, the Chairman turned to the question of preference as between retaining the language of the existing current economic policy directive without change or eliminating the two clauses mentioned earlier in the meeting by Mr. Hayes.

Of the ten members of the Committee who had previously indicated that they favored maintenance of the status quo for the next three weeks, Chairman Martin and Messrs. Bryan, Deming, Fulton, King, and Mills expressed a preference for not changing the directive in any respect at this time, while Vice Chairman Hayes and Messrs. Balderston, Ellis, and Shepardson indicated that they would prefer to delete the two clauses in question. Accordingly, it was understood that the suggested changes would not be incorporated in the directive.

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

It is the current policy of the Federal Open Market Committee to permit the supply of bank credit and money to increase further, but at the same time to avoid redundant bank reserves that would encourage capital outflows internationally. This policy takes into account, on the one hand, the gradualness of recent advance in economic activity the availability of resources to permit further advance in activity, and the unsettlement of financial markets. On the other hand, it gives recognition to the bank credit expansion over the past year and to the role of capital flows in the country's adverse balance of payments.

To implement this policy, operations for the System Open Market Account during the next three weeks shall, to the extent consistent with the behavior of financial markets, be conducted with a view to providing moderate reserve expansion in the banking system and to fostering a moderately firm tone in money markets.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bryan, Deming, Ellis, Fulton, King, Mills, and Shepardson. Votes against this action: Messrs. Mitchell and Robertson.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, August 21, 1962.

There had been distributed to the Committee a report from the Special Manager of the System Open Market Account regarding System and Treasury operations in foreign currencies and on foreign exchange market conditions for the period July 10 through July 25, 1962, as well as a supplementary report for the period July 26 through July 30, 1962. Copies of these reports have been placed in the files of the Federal Open Market Committee.

Chairman Martin called upon Mr. Sanford for comments in supplementation of the written reports, and in response Mr. Sanford made a statement substantially as follows:

The time since the last Open Market Committee meeting breaks down into two distinct periods. The first ran from July 10 to July 20, during which the dollar continued to be under constant strain, and the second began on Monday, July 23, and continues up to the present time, during which there has been a considerable firming of the dollar. The marked change, of course, is related to President Kennedy's firm statement at the Press Conference of July 23 transmitted by Telstar that "The United States will not devalue its dollar. And the fact of the matter is the United States can balance its balance of payments any day it wants if it wishes to withdraw its support of our defense expenditures overseas and our foreign aid." Even before the President's statement, a slight easing of the Swiss franc rate and reduction in the demand for gold had already occurred early in the day on July 23, but by far the larger impact came after the President's statement reached Europe.

On July 10 it will be recalled that the principal European continental currencies, with the exception of the German mark, were at or very close to their ceilings. Now the Swiss franc, the Netherlands guilder, and the Belgian franc and, of course, the German mark are appreciably below their ceilings. The French franc and the Italian lira, however, remain firmly anchored to their ceilings, and showed only slight tremors immediately after the President's statement. For several days the Italian authorities did not have to take in dollars, part of which are absorbed by the U. S. Stabilization Fund, but more recently the inflow has been resumed. In talking with the Bundesbank on the telephone yesterday, the head of their foreign exchange activities took the occasion to point out that over the past weekend the dollar improved--the first weekend improvement in some time. With the DM now at $0.250237 (par being 25 cents), we have placed with the Bundesbank an order to acquire up to $15 million equivalent of DMs at par as and when that level should be reached, in order to replace DMs sold during the holding operation of June and July. I would mention at this point that further small sales of DMs (0.5 million) were made in the early days of the past three-week period--by the System and the Treasury. The System sales early in the period, like the sales

of DMs made in the preceding three weeks, were made under the Open Market Committee's Authorization and Guidelines dated February 13, 1962.

Turning to the guilder, the total amount of the $50 million swap arrangement with De Nederlandsche Bank has now been used in mopping up dollars accumulated by De Nederlandsche Bank. This has been done in several steps and throughout the period the thought was always present that the Dutch were free to take gold if they felt they were compelled to do so. Actually this was avoided by the Dutch suggesting that another swap arrangement of $50 million be entered into, and as the Dutch did not wish to give any publicity to this further amount, arrangements were made for the U. S. Stabilization Fund to enter into this undertaking. A part ($15 million) of the Treasury's arrangement with the Dutch has been used to provide guilders to the Bank of England, which needed them for its repayment to the International Monetary Fund, and thus to take the Bank of England out of the market as soon as possible so that the Treasury could proceed with its operations in the forward guilder market; and $5 million of guilders has been drawn and placed on deposit. It was also believed that a shorter-term swap arrangement was in order because of the possibility in August of a substantial repayment of funds by K.L.M. to United States banks. This morning the guilder stands at 27-3/4 cents, appreciably down from its ceiling.

In other operations, I would mention that the $50 million reciprocal swap arrangement with the Bundesbank, approved by the Federal Open Market Committee by telegram, is being made effective on August 2; a press statement will be issued on that day. The arrangement is on a standby basis and drawings may be made at any time on two days' notice, if they should be required. The French have also indicated that their swap arrangement should be on a standby basis and it now seems appropriate to accede to their wishes coincident with establishing the German arrangement on a standby basis. The Dutch, Germans, and French have all wanted their swap arrangements to be on a standby basis, a pattern which is now becoming more widespread, with the Netherlands, Bank for International Settlements, Swiss National Bank, and German arrangements on that basis. We have had discussions with the Banque de France, and subject to Committee approval, will liquidate on August 2 the swap drawing and the arrangement will be put on a standby basis as from that date.

Within the past three-week reporting period, the Swiss franc swap arrangements with the Swiss National Bank and the Bank for International Settlements were established, as you know, and half of the $200 million was drawn and used to mop

up dollars acquired by the Swiss National Bank. These arrangements were approved by the Committee at its last meeting, and subsequently reported to the members and other Presidents. This morning the Swiss franc is quoted at $0.2313, also appreciably below the Swiss intervention point.

Now a few words on the London gold market. The demand there increased markedly between July 10 and July 20. The volume of transactions reached record levels and the fixing price went from $35.1138 on July 10 to $35.1434 on July 20. Since that time the turnover has declined very considerably, although it is still at a higher level than earlier this year, and the price has receded, to $25.1121, today. During the period of greatest volume, the Bank of England had to sell more gold than it had accumulated in previous months and it has replaced the greater part of this gold by a purchase of $50 million from the United States in the reporting week ended last Wednesday. Reactivation of the central bank selling consortium has been considered with the central banks but no action has been taken pending further observation of developments in the London gold market.

Sterling, like the Continental currencies, was very firm in the period between July 10 and 20, rising from about $2.80-1/2 to $2.80-3/4, but since that time has tended downward, and is now back to $2.80-1/2. The Canadian dollar was very strong during most of the three weeks, advancing from $0.9269 to as high as $0.9277, but has recently eased back to $0.9272. In the process the Bank of Canada has accumulated very large amounts of United States dollars, perhaps in the order of $300 million.

At this moment I would request your approval of the revision of the swap arrangement with the Bank of France. The other swap arrangements referred to before have already been approved by the Committee. And I also request ratification of the sales of DM 0.5 million, plus 1 million sold in the previous period and delivered in the three-week period just closed.

Following Mr. Sanford's comments there was a discussion during which question was raised with regard to public announcement of swap arrangements on a standby basis, particularly in a case such as the proposed conversion of the swap with the Bank of France to a standby basis.

Mr. Sanford's reply brought out that in all of the swap arrangements entered into thus far the terms of the public announcement had been

the same no matter whether the swap was immediately activated (as, for example, in the case of the British and French swaps) or whether the swap was on a standby basis (as originally was true in the Dutch case). In other words, no distinction was made on that account so far as the press release was concerned. Accordingly, if the French swap or others were converted to a standby basis, it was not contemplated that any public announcement would be made. It was not expected that the mechanics of accounting, at least on the Federal Reserve side, would be such as to elicit any questions. However, if any questions should be asked, it was proposed to answer in terms that a technical change was involved and the swap arrangement continued in force.

Mr. Sanford also brought out that presumably a standby swap arrangement would be drawn upon only to spend the proceeds immediately, so the transactions would wash out from the standpoint of foreign currency holdings. When an active swap arrangement was converted to a standby basis, there would of course be an effect on "other assets," but there are large swings in that account for other reasons.

In reply to another question, Mr. Sanford confirmed that all of the outstanding swap arrangements were subject to renewal only upon agreement by the two parties. With one exception, the swap arrangements were on a three-month basis. One swap (with the Bank of France) had been renewed for a three-month period.

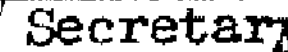
In reply to a question as to whether an initial swap arrangement with the Netherlands Bank in an amount larger than $50 million would not

appear to have been desirable, Mr. Sanford expressed his understanding that at the time the Netherlands Bank was not inclined to enter into an arrangement in excess of that figure. In the light of subsequent developments, it now appeared that an arrangement involving more than $50 million could have been useful, but that was in the nature of hindsight.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in foreign currencies during the period July 10 through July 30, 1962, were approved, ratified, and confirmed.

Upon motion duly made and seconded, and by unanimous vote, authorization was given for the liquidation of the existing swap arrangement with the Bank of France and its replacement by an arrangement on a standby basis.

The meeting then adjourned.



Secretary