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, January 8, 1963, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston
Mr. Bryan
Mr. Deming
Mr. Ellis
Mr. Fulton
Mr. King
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Treiber, Alternate for Mr. Hayes

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

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

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Brandt, Brill, Garvy, Hickman, Holland, Koch, and Parsons, Associate Economists
Mr. Stone, Manager, System Open Market Account
Mr. Coombs, Special 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. Hersey, Adviser, Division of International Finance, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Eastburn, Black, Baughman, Jones, Tow, and Green, Vice Presidents of the Federal Reserve Banks of Philadelphia, Richmond, Chicago, St. Louis, Kansas City, and Dallas, respectively
Mr. Lynn, Assistant Vice President, Federal Reserve Bank of San Francisco
Mr. Sternlight, Manager, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 4, 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 December 18, 1962, through January 2, 1963, and a supplementary report covering the period January 3 through January 7, 1963. Copies of both reports have been placed in the files of the Committee.

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

The past three weeks have been particularly eventful ones, and it may be worth while to report on developments in a little more detail than I ordinarily do. The essential problem confronting the Desk during the period was to move to the policy of slightly less ease adopted by the Committee at the last meeting, and to make this move in such a way and in such time that the market would have an opportunity to digest the change before today's auction of $250 million Treasury bonds. The move to the new policy was made rather difficult by erratic swings in reserve statistics, and rather delicate by a building up of dealer positions in Government securities to record levels.

At the time of the last meeting, which took place immediately after the December tax date, dealer positions were in the neighborhood of $4.2 billion, up from around $3.7 billion earlier in the month. Dealers' use of credit had also expanded and, following the shift in policy at the last meeting, we permitted the reserve pressures associated with the tax date to be felt slightly more forcefully than if that shift had not been made. Dealer loan rates thus moved up and dealers found themselves paying 3-1/4 - 3-1/2 per cent to finance Treasury bills that they had acquired at rates of 2.80 - 2.90 per cent.

Despite these heavy financing costs, dealers bid very aggressively in the auction held on December 21, and were awarded a total of $907 million bills in the auction--an all-time high. After that auction, dealer positions reached nearly $5 billion--also, in all likelihood, an all-time high--and on the following Thursday, when payment for the new bills had to be made, dealers' new financing requirements for that day amounted to $1.4 billion--which may well be another record.

The reaction of short-term rates to these developments, and to the publication each week of somewhat lower free reserve figures, was relatively mild. Indeed, three-month bills, which had closed at 2.87 per cent on the day of the last meeting, moved to a maximum of 2.93 per cent on December 28, the day after a free reserve figure of $286 million was published, and after that $1.4 billion of financing had to be found. Short rates subsequently declined under the force of heavy demand, and reached 2.86 per cent last Thursday. The publication of a $236 million free reserve figure last Thursday afternoon, together with some lessening of demand on Wednesday and Thursday after the heavy demand of the two preceding days--dealers sold a total of $800 million bills over those two days--led to a rise in the three-month rate to around 2.90 per cent. Yesterday the rate closed at 2.91 per cent--only 4 basis points above the rate at the beginning of the period. Dealer positions, meantime, had come down to about $3.6 billion.

This rise of 4 basis points is an unusually small rate change indeed under circumstances in which policy has changed and in which dealer positions, and the cost of carrying these positions, have been particularly burdensome. The major reason why the rise in short rates has been so limited is of course the force and vigor of the downward rate pressure anticipated by the Committee at the last meeting. An additional reason is that the expectational reaction that typically flows from a change in policy was on this occasion substantially muted. Since free reserves had moved rather widely during the several weeks preceding the last meeting, and since such figures tend to swing erratically around the year-end period in any event, the market has moved cautiously in attaching policy significance to the lower figures that have been published. By now, the market consensus that policy has undergone a slight shift is pretty fully developed, and the absence of any marked rate increase over the past two days suggests that such expectational reaction as may have occurred is probably already spent.

Meanwhile, the Treasury bond market has shown some reaction, also moderate, to the market view that System policy has shifted slightly in the past few weeks. For the first few days of the period since the last meeting, bond prices were working higher on the basis of a moderate investment demand and dealer efforts to cover short positions and prepare for expected reinvestment demand after the turn of the year. Indeed, by Christmas Eve a number of Treasury bond issues had reached new high price levels for the year. After Christmas, a more cautious atmosphere set in--partly a technical reaction to the preceding sharp increases, but also reflecting the cumulative impact of lower reserve figures, a firmer money market, and continued indications of concern with the balance of payments. By yesterday's close most intermediate issues were down about 1/4 point since December 17, and some of the longest issues were down 5/8 to 3/4 point. Yesterday, after small early markdowns, prices moved slightly higher.

The approach of today's long-term bond auction may have exerted an additional cautionary influence on the long market, over the past week or two, but there was no strong effect from this source as it has been expected that this $250 million offering would be rather quickly distributed--provided it is priced realistically. Over the past week or two, market discussion of possible reoffering rates on the new bonds has ranged between about 4.00 and 4.10 per cent, but sentiment now seems to be gravitating toward the lower end of that range, particularly after yesterday's aggressive bidding for $70 million Aaa-rated New York Telephone bonds, which seemed to be getting off to a fairly good start despite the relatively low reoffering yield of 4.21 per cent. We may learn the results of today's Treasury bond auction later this morning.

Tomorrow, the Treasury is auctioning $2.5 billion of one-year bills, rolling over the issue that matures January 15 and raising $500 million new cash. Current rate discussion for the one-year bills is in the 3.02-3.05 per cent area. Taken together, this week's auctions of bonds and bills will raise $750 million of the Treasury's estimated $3 billion cash needs in the first quarter of 1963. Another $200 million was raised by enlarging the first two weekly bill auctions of the year. For the remainder of its first quarter cash needs the Treasury is currently thinking in terms of selling about $2 billion of June tax anticipation bills, probably in two instalments--one in early February and the other in early March. Additions to the regular weekly bill offerings, which have been made almost constantly for the past year, are now to be halted until the end of March, at which time the Treasury is planning to round out its $2.1 billion weekly cycle by adding $100 million to the offerings starting with the auction on March 25 and continuing for seven more weeks. Aside from these cash borrowings, the Treasury will of course have to refund $9.5 billion of February 15 maturities.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities during the period December 18, 1962, through January 7, 1963, were approved, ratified, and confirmed.

Before this meeting there had been distributed to the Committee a report from the special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period December 18 1962, through January 2, 1963, together with a supplementary report covering the period January 3 through January 7, 1963. Copies of these reports have been placed in the files of the Committee.

In his comments supplementing the written reports, Mr. Coombs first discussed recent developments in the London gold market, which in general had been encouraging. In this connection he cited the results of recent operations of the gold pool and a decision on the part of the U. S. Treasury to reallocate its share of a gold distribution from the pool to certain European central banks having low ratios of gold in relation to dollar reserves. Mr. Coombs also noted that the U. S. gold stock probably would remain unchanged this week for the tenth successive week, after which he summarized anticipated demands for gold that might be made in the next few months by several foreign central banks.

This led to comments by Mr. Coombs on the possible magnitude of gold orders that might be received from the Bank of England as the British came into the normal seasonal period of trade surplus, which would run through May. There had been an informal estimate that the surplus during the first half of this year might run to at least $400 million. If this were all converted into gold, such purchases--combined with the other prospective demands for gold that he had mentioned--might reduce the U. S. gold stock by $600 to $700 million during the first half of the year. In the circumstances, it had been suggested to a representative of the Bank of England that a program along somewhat the following lines might be considered to deal with a British surplus in the range of $400 million. First, the Bank of England might take gold in sizable amount; this would make it clear that the gold was available when wanted. Second, a swap arrangement between the Bank of England and the Federal Reserve in the amount of $250 million might be negotiated. (Several months ago a swap of such magnitude had been given some consideration, but it was not consummated at the time.) Third, there might be an increase in the dollar balances of the Bank of England from around $300 million to around $350 million. Mr. Coombs was of the opinion that a swap arrangement in the amount mentioned would have the support of the Bank of England, and he hoped that it might be possible to execute such a swap in due course. It might be necessary, however, to act in two steps: first, a drawing of $50 million under the existing swap arrangement, followed by discussion of an enlarged swap agreement, with pay-off of drawings thereunder anticipated in the second half of the year when the British would normally be moving into a seasonal deficit.

Mr. Coombs then referred to the prospective $50 million swap agreement with the Bank of Sweden, the negotiation of which was authorized by the Open Market Committee at its meeting on December 4, 1962, and explained why it had not been possible thus far to find a satisfactory investment outlet for the krona balances that the Federal Reserve would acquire in the event of a drawing under the swap facility.

Mr. Mills raised at this point certain questions relating generally to the attitude that would be appropriate for U. S. authorities in dealing with matters such as had been mentioned by Mr. Coombs, including reallocation of distributions from the gold pool and the consummation of the swap arrangement with the Bank of Sweden. In the latter connection, he noted that the difficulty encountered in working out the proposed swap arrangement apparently was attributable in part to existing

U. S. legislation, which led him to inquire whether the appropriate course might not be to discontinue the negotiations for a swap arrangement unless there should be some change in the existing legislation.

In respect to the first part of the question, Mr. Coombs outlined considerations that he understood the Treasury to have had in mind in connection with the gold pool reallocation. His recital of these considerations, which he considered valid, led to a general discussion with regard to the range of gold ratios of the principal European central banks and the extent to which some improvement of the lower ratios might tend toward conditions of stability. It was emphasized during this discussion that the subject involved responsibilities of the Treasury rather than the Federal Reserve.

With regard to the question concerning the negotiations with the Bank of Sweden regarding a swap arrangement, Mr. Coombs commented that a problem of concern to him was the possibility of winding up with essentially a one-sided relationship, in which the Bank of Sweden would be prepared to make krona balances available to the Federal Reserve but could not effectively take advantage of the reciprocal features that were essential to swap arrangements. He then spoke of factors that led him to feel that it would be desirable for the Federal Reserve to try to complete its network of swap arrangements. It was his hope that before long the network of such arrangements could be described as nearly complete and constituting an effective network of mutual support.

In reply to a question as to what he would have in mind, beyond the Swedish swap, for completion of the network for swap arrangements, Mr. Coombs referred to the possibility of a swap arrangement with the Bank of Japan and cited several factors that might weigh for or against the consideration of such an arrangement. Balancing those factors, it was his present inclination to wait a while.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period December 18, 1962, through January 7, 1963, were approved, ratified, and confirmed.

Mr. Coombs then presented several recommendations for the consideration of the Open Market Committee.

First, he recommended that the Committee authorize renewal for three months of the current swap arrangements with the Bank of Italy, the Swiss National Bank, and the Bank for International Settlements in the amounts of $150 million, $100 million, and $100 million, respectively, all of which would mature January 18, 1963. He also recommended renewal of drawings of $35 million under the swap arrangement with the Bank for International Settlements and $50 million under the swap arrangement with the Swiss National Bank, which drawings would mature January 18, 1963.

> Thereupon, extension for three months each of the swap agreements with the Bank of Italy, the Bank for International Settlements, and the Swiss National Bank, as recommended by Mr. Coombs, was authorized, with the understanding that the drawings to which he had referred under the swap arrangements with the Bank for International Settlements and the Swiss National Bank would also be renewed.

Second, Mr. Coombs recommended repayment of the $50 million drawing under the swap arrangement with the Austrian National Bank, which would mature January 24, 1963, and renewal of the swap facility in the form of a standby arrangement in the amount of $50 million for three months.

> The repayment of the $50 million drawing under the current swap arrangement with the Austrian National Bank was noted without objection and renewal of the swap arrangement with the Austrian National Bank on a standby basis for three months, as recommended by Mr. Coombs, was authorized.

Mr. Coombs then referred to the general discussion several months ago with the Bank of England, pursuant to Committee authorization, regarding the possibility of an enlarged swap facility, with $250 million having been cited at the time as a rather rough figure. He recommended that authorization now be given for further negotiations with the Bank of England in terms of a $250 million swap. As he had indicated previously during this meeting, this would be in anticipation of a reversal of the British surplus position in the first half of the year to a deficit in the second half. In response to a question, he noted that the British would have the option of requesting gold in reflection of their surplus position. Negotiations with respect to a possible swap arrangement might be in terms of whether, on the basis of international cooperation, the British would be interested in such an arrangement as an alternative to the taking of gold.

In further discussion, Chairman Martin referred to the fact that, as mentioned by Mr. Coombs, negotiations had been under way some time ago with a view to the possibility of a swap of the magnitude now suggested. The formulation of the so-called Maudling Plan, which was presented at the Fund and Bank meetings in the fall, constituted a deterrent. However, the prospect of such plan being put into operation. at least in the near future, now seemed rather unlikely, and in the circumstances the British might be more inclined to reconsider the swap arrangement. As Mr. Coombs had indicated, this should be thought of essentially in terms of providing a bridge between the first half and the second half of this year.

Asked for an opinion on whether the $400 million British surplus that had been mentioned earlier as a possibility for the first half of the year seemed to represent a reasonable estimate, Mr. Coombs responded that in the light of various developments, some of which he enumerated, the surplus could develop to be either larger or smaller than the figure mentioned. In view of this range of possibilities, it was his judgment that a swap in the magnitude of $250 million could prove useful to both parties to the agreement.

After further discussion of various elements of the prospective situation, further negotiations with the Bank of England looking toward the execution of a swap arrangement in the amount of as much as $250 million were authorized.

Mr. Coombs next suggested the desirability of negotiating with the German Federal Bank for an increase of the current $50 million swap arrangement to $150 million, which would be in line with the increase that had been effected recently in the swap facility with the Bank of Italy and generally in line with the proposed enlargement of the swap arrangement with the Bank of England.

After discussion, negotiations looking toward an increase from $50 million to $150 million in the swap arrangement with the German Federal Bank, as recommended by Mr. Coombs, were authorized.

It was pointed out that the continuing authority directive to the Federal Reserve Bank of New York on System foreign currency operations, last amended October 2, 1962, contained a provision that total foreign currencies held at any one time should not exceed $1 billion. In light of the authorizations that had been given at this meeting, it was suggested that the limitation might appropriately be raised to $1.3 billion.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Federal Open Market Committee, to execute transactions in the System Open Market Account in accordance with the following continuing authority directive on System foreign currency operations:

The Federal Reserve Bank of New York is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the

Guidelines on System Foreign Currency Operations issued by the Federal Open Market Committee on February 13, 1962, and amended November 13:

Pounds sterling
French francs
German marks
Italian lire
Netherlands guilders
Swiss francs
Belgian francs
Canadian dollars
Austrian schillings

Total foreign currencies held at any one time shall not exceed $1.3 billion.

Mr. Deming referred to a suggestion that had been made by Mr. Mitchell at a recent Committee meeting relating to the preparation of a paper outlining for the Committee's consideration criteria that might be helpful in determining the magnitude of swap facilities with the foreign central banks of various foreign countries. He inquired whether progress was being made in the preparation of such a document.

It was noted, on this point, that the staff had recently been distributing memoranda regularly with respect to the economic and financial situation of foreign countries where swap arrangements, or renewal or enlargement thereof, were in possible prospect. It was indicated that work would proceed in an effort to develop a document of the character contemplated by the suggestion to which Mr. Deming had referred.

This concluded the Committee's consideration of System foreign currency operations and related matters.

Accordingly, the Chairman called for the usual staff reports on economic, financial, and balance of payments developments.

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

As far as available evidence goes, it looks as though December was more of the same--some types of economic activity up slightly, some down slightly, and not much change over all. Preliminary estimates indicate that the unemployment rate in December edged down slightly, but only to a level well within the range prevailing throughout 1962. There is nothing to suggest that our measure of total industrial output for December will be significantly different from November, or for that matter from what it has been since last midyear.

As for consumer demands, a late rush of Christmas buying pushed up retail sales for the month, with strong buying of nondurable goods apparently offsetting a further and sizeable cutback in automobile sales. Adverse weather and strikes in some areas undoubtedly held down the sales figures, and possibly some of the employment statistics for the month,but disentangling basic economic forces from the influence of transient ones such as weather and strikes is difficult. By and large, there seems to have been little change in the balance between expansionary and contractive forces at year-end.

Looking back over the year, 1962 didn't contribute much more in the way of expansion after the sharp cyclical run-up in 1961. From year-end to year-end, deflated gross national product per capita rose by only 1 per cent, well below the almost 8 per cent annual rate in the first phase of recovery and somewhat below the average for the past decade.

In terms of cyclical behavior, however, 1962 was not unusual. In the two preceding cycles, initial periods of rapid recovery were also followed by periods of relatively slow expansion which lasted for some time before the cyclical peak was reached. This past upswing differed somewhat from its predecessors in that the period of rapid recovery was shorter, but the rate of rise in this phase was somewhat faster. The current level of real GNP, therefore, is up from the cyclical trough of early 1961 by just about the same amount--roughly 1/10--as it was after similar time periods following the 1958 and 1954 troughs.

A pattern of rapid upswing from cyclical troughs followed by a period of much slower expansion seems perfectly natural--in terms of inventory behavior if nothing else. What is disturbing is that the slowing up of the expansion in the past two cycles occurred when our productive potential was substantially underutilized, and occurred at successively higher rates of unemployment. Even at the height of the hectic steel inventory buildup in the spring of 1959, there was still some 12-13 per cent of manufacturing plant idle and about 5 per cent of the civilian labor force unemployed. This past year, expansion again slowed when plant capacity was unutilized by 13-14 per cent and over 5-1/2 per cent of the labor force was still seeking work. The critical problem in recent years seems to have been not so much what starts a recovery or ends a boom, as what causes the economic slowdown in the expansion phase at less than full use of our resources.

It is an increasingly widespread conviction among economists, businessmen, labor leaders--and some Congressmen--that the size and structure of the Federal tax take is the culprit. Given the announced intent of the Administration to do something about it, in the weeks ahead we are likely to be barraged with visions of the economic paradise to follow enactment of this or that tax reduction program.

We still don't know the specifics of what the Administration will propose re taxes, and to say the least we are not in any position to judge what will emerge after Congressional deliberation. As economists, however, we have some basis for maintaining at least a modicum of skepticism as to whether any likely tax cut will be as efficacious as is contended. By now, we should all be sufficiently impressed with the complexity of economic interrelationships to doubt any single cause or any single remedy for persistent economic ills.

In earlier cyclical upswings, for example, the development of unsustainable price and cost relationships was assigned much of the blame for curtailing expansions. But these have played little part in the recent leveling off. Industrial prices as a whole were little changed throughout 1961 or 1962 and, for that matter, have been stable since early 1959. Labor costs per unit of manufacturing output edged down again last year, continuing the downtrend evident since 1958.

Another symptom often misconstrued as <u>the</u> basic cause is an inadequate rate of new business investment, which over the past 5 years has not kept pace with the growth in total activity. In fact, it is only in recent months that business capital outlays have finally re-achieved the earlier peaks of 1957, while total output (GNP in constant dollars) is now some 15 per cent higher than it was 5 years ago.

But business decisions on investment are not autonomous, and must reflect assessments of other economic variables such as profits and markets. Declining profit margins have undoubtedly weakened incentives for plant expansion in recent years. This, in turn, must have reflected at least in part the underlying failure of the economy to make adequate use of additions to capacity. Even at the height of the rapid expansion phase of the last two cycles, capacity utilization rates in manufacturing were well below those that touched off the investment boom of 1955-57. We seem much less able than earlier in the postwar period to validate the optimistic plans made by businessmen in the initial phases of recovery.

Total consumption expenditures have continued to rise, but only in close conformance to the rise in income. The spending rate has stayed between 92 and 94 per cent of disposable income for the better part of a decade. Moreover, there has been a substantial shift in the composition of spending. The portion of income devoted to goods has been declining and the part devoted to services rising substantially. In upswings, spending for goods has tended to slow up in the second or decelerating phases of recoveries, while spending for services has maintained its early recovery pace.

Assuming that on the whole a rise in service expenditures exerts a smaller draft on productive capacity than a comparable rise in consumer outlays for goods, one might advance this compositional shift as part of the explanation of our failure to lift manufacturing capacity utilization to former peaks, and also perhaps in part as an explanation of the persistent decline in manufacturing employment. One must also wonder, however, about the kind of tax reduction needed to arrest or reverse such trends in consumer preferences.

I would hope that this analysis, incomplete as it may be, is not construed as an argument against a significantly large fiscal action at this time. Some stimulus seems needed if the economy is to achieve a more satisfactory growth rate, and tax reduction appears to be the most generally acceptable type of stimulus. Even if the structure of private demands can't be modified, a rise in the total may still provide enough incentive to invigorate business investment plans. It would seem prudent, however, to restrain optimism about economic prospects in the months ahead, not only until the shape of the tax reduction program becomes clearer but until we can get a better reading on the economy's likely response.

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

By and large, financial markets can be said to have accepted the recent change in monetary policy with considerable aplomb. Awareness of the policy change seemed to develop more or less gradually, and its influence on attitudes blended in with a variety of other expectational factors that at least partly balanced each other out. It can be noted that this policy change occurred during a period of record build-up in dealer inventories and sharp expansion in bank credit demands--the ingredients that often have given rise to sharp reactions to policy changes in the past. The fact that no such marked reaction occurred on this occasion reflected a variety of factors; I might cite the smoothness of Desk operations, the mildness of the actual policy change, the relatively narrow bounds within which many observers believe monetary policy can be changed in any case in the current circumstances, and probably also some deep-seated market convictions that some of the recent credit expansion was temporary, and that the underlying flows of investible funds will continue large relative to expected borrower demands.

Bank credit expansion and reserve utilization accelerated during December. In fact, deposit increases appeared to grow larger as free reserves dropped; but this is not so confounding when one realizes that much of the decline in free reserves resulted from successively stronger than projected increases in required reserves.

In some respects the recent experience is reminiscent of last year, when a temporary year-end burst of credit expansion distorted the reserve figures for several weeks. Closer examination points up at least three differences, however. This year's expansion stretched over a somewhat longer period; there was even more miscalculation of pressures by banks in the climactic year-end week; and, thus far, there appears to be a less rapid reversal of the bulge in the early days of the new year.

A major influence in the December bank credit rise, as Mr. Stone has pointed out, was the larger than usual bank borrowing by Government securities dealers to carry their enlarged bill inventories. The dealers seemed sufficiently confident of a strong bill market after the turn of the year to willingly incur a negative carry in a goodly portion of their short-term portfolio during the days of peak tightness, and indeed this attitude appears to have been vindicated in good part by the subsequent rapid rate of market absorption of bills by investors.

Some other categories of bank credit also showed strength in recent weeks. Certain categories of business loans were strong--particularly utility credits--not so much over the conventional tax and dividend dates as at other times when the borrowing often appeared related to a conscious choice of bank borrowing in preference to open market financing. Bank real estate, consumer, and agricultural loans all continued the fairly steady pace of advance characteristic of other recent months.

This performance topped out a year of record increases in bank credit and deposits. Banks extended their full share of a cyclical increase in consumer credit, somewhat more than their share of a substantial increase in mortgage debt and external business debt, and the dominant portion of credit extended to State and local governments. The only major borrowing sector that did not draw upon the commercial banks during 1962 was the Federal Government; while month-to-month changes were sizable, no part of the 1962 Federal deficit was financed by the commercial banking system on a net basis.

The bank loan increase during 1962 was financed, of course, essentially by the expansion of time deposits, which grew more than twice as fast as over-all public liquid assets, which themselves increased about twice as fast as the year-to-year advance in GNP. Demand deposit expansion has come along more rapidly beginning this fall, however. During December, the bank credit expansion was mirrored in the sharpest monthly increase in the average money supply in four and one-half years--this despite a smaller than usual decline in Government deposits and a continuation of the enhanced rate of growth in time deposits characteristic of the fourth quarter.

Broadly viewed, however, the money and capital markets evidenced relatively moderate reactions, both to these outsize bank credit flows and to the slowly apprehended change in System policy. The modest interest rate movements may be the market's own signal that the big credit movements of the last few weeks are largely transitory. They also suggest that markets are in a relatively well-balanced position to meet the tests immediately ahead. Testing of the long-term market will come from the post-holiday rebound of new offerings this week, highlighted by the Treasury's $250 million offering to underwriters today. In the short market, the acid test will be the degree of persistence in nonbank bill demand. If nonbank demand continues strong, it could give rise to something of a dilemma for monetary policy, contracting bank credit and deposits and, at the same time, depressing bill rates relative to other rates more sensitive to bank reserve and portfolio positions.

The imminence of these tests, and the turbid nature of recent financial flows, all seem to invite a "wait and see" attitude with respect to any policy adaptations. The Treasury financing schedule also is an influence in this direction. Presumably, an "even keel" policy will be appropriate for the next few days to allow for digestion of the $250 million bond issue, and an "even keel" would again be appropriate around the date of the next meeting of the Committee, as the Treasury will probably be announcing its February 15 refunding offering in that week. In between, the Treasury will also be marketing a $2.5 billion one-year bill issue on January 9 and perhaps a $1 billion June tax bill either late in this month or early next month; but it should be remarked that these bill issues are easily merchandised offerings and are partly intended to create some market pressure, and therefore their inhibition of System actions need not be great.

Whatever the policy prescription may be today, let me conclude with the point that the current combination of reserve and money market statistics is not likely to be a very viable base from which to judge either "change" or "no change" in the weeks ahead. For one thing, the current week has an extra ingredient of ease from the unwinding of cumulative country bank excess reserve positions built up prior to the year-end. For another, the year-end upthrust of credit demands gave many banks a justification for temporary borrowing from the Federal Reserve that undoubtedly cushioned the restrictive effect thereof. With such justification fading as time passes, and with the January flows of funds typically redistributing reserves in ways which tend to delay their full effectiveness, it could well take a somewhat higher range of free reserves than the $250 million average of the past two weeks to maintain something like the same degree of marginal bank credit availability.

In a discussion based on the foregoing staff presentations, Mr. Mills brought out that while no part of the 1962 Federal deficit had been financed by the commercial banking system on a net basis, at the same time there had been a vast shift in the composition of portfolios as the commercial banks acquired State and municipal obligations in preference to Federal obligations. Thus, another area of Governmental deficit had been financed by the commercial banking system. However, there was the satisfaction, from the standpoint of inflationary impact, of noting that this financing had been accomplished out of increased time and savings deposits.

There followed several questions by Mr. Balderston for the purpose of clarifying figures contained in the staff briefing for this meeting, particularly with regard to the change in GNP during the past year in relationship to the increase that had occurred during the past several months in required reserves against demand deposits. Asked for comment with regard to the appropriateness of Federal Reserve policy in light of the recent increase in required reserves, Mr. Holland noted that a substantial pickup in demands for bank credit began to be evident about the end of the summer. Until December, when monetary policy and market conditions began to apply some restraint, the effect of System policy had been to permit the accommodation of those demands without any substantial restraining influence. Thinking of System operations in light of the actual bank credit demands that had developed, he felt it could be said that such operations had not been inappropriate. Generally speaking, bank funds had been used in ways that did no damage to the economy; on the contrary, they had contributed to growth in some sectors that had provided the strongest support to expansion of domestic economic activity.

Mr. Hersey presented the following statement with respect to the U. S. balance of payments:

> My remarks will cover three topics, the balance of payments outcome for the fourth quarter and the year 1962, shifts in

private capital flows in 1962, and the means by which the 1962 payments deficit was financed.

1. Very preliminary figures indicate that the published balance of payments deficit will be under $1/2 billion for the fourth quarter and under $2 billion for the year 1962. A recomputation of the deficit, as the sum not only of the decline in U. S. gold reserves and convertible currency holdings and the rise in U. S. "liquid liabilities," but adding in also foreign prepayments of long-term debt to the United States and the rise in U. S. Government "nonliquid liabilities," gives an estimate for the fourth quarter not far from $1 billion and for the year as a whole about $3-1/4 billion. On a similar basis, the 1961 deficit was $3.2 billion.

As to the difference between the two measures of the deficit for the year 1962--one under $2 billion and the other over $3 billion--debt prepayments account for $666 million of the difference. The remainder represents Treasury borrowings for periods over 1 year with nonnegotiable instruments from Switzerland and Italy, increases in foreign funds committed for military purchases in the United States, and increases in funds held by the International Development Association and the Inter-American Development Bank as reserves in non-interest-bearing nonmarketable securities.

2. If we take a look at private capital movements, broadly defined without regard to how they are placed in the balance of payments accounts (above or below the line at which the deficit is measured), we find two really major changes in the flows between 1961 and 1962.

First, the <u>outflow</u> of U. S. bank loans and acceptance credits dropped from $900 million in 1961 to what looks like being less than $1/4 billion in 1962. Second, the <u>inflow</u> of foreign commercial banks' funds into liquid assets in the United States fell off from $600 million in 1961 and became for the year 1962 as a whole an outflow--i.e., a reduction in their holdings--which may have reached 2 or 3 hundred million by the end of the year.

Neither of these two major changes in private capital movements were basically determined by interest rate developments here or abroad. Of the shrinkage in U. S. bank credit outflow, approximately $1/2 billion was in the flow to Japan, which was over $600 million in 1961 but far less than that in 1962. Since last March, in fact, Japanese short-term indebtedness to the U. S. has not grown any further, and last autumn it began to be reduced a little. The governing factor, I believe, has been the attitude of the Japanese authorities, who were unwilling to see a further buildup of what is now a very large aggregate of short-term debt, including what is owed to Europe. They were able to get along without further large inflows when the drop in Japanese imports and rise in Japanese exports began to relieve the balance of payments difficulties that had been so acute for Japan in the latter part of 1961.

The cessation of the 1961 buildup in foreign commercial bank liquid assets in the United States is probably best thought of as related to the functioning of the Euro-dollar market, and also in connection with the ending of Germany's previous large surpluses in international payments. In 1961 one of the major sources of dollar funds to the Euro-dollar market was the German central bank, which supplied dollars to German commercial banks with exchange risks covered, on relatively attractive terms. With the turn in Germany's payments position, and after the experience at the end of 1961 of some really huge window-dressing operations, in which the German banks repatriated a large amount of the liquid assets they had been holding abroad and then put an even larger amount out again in January 1962, the Bundesbank took various actions to discourage such large movements in and out in the future. In doing this it brought German domestic money market rates up from the 2 per cent level, abnormally low in relation to German interest rates in general, to which it had reduced those rates in 1961. From the end of January to the end of November, the German banks' liquid assets outside Germany were run down by $600 million, and this movement, I believe, was undoubtedly the main factor accounting for the fact that over the same period total foreign commercial bank holdings of dollars in the United States dropped by $600 million.

I mention these two major changes in capital flows only in order to remind you of what I am sure you are already aware of: that the purposes served by keeping U. S. money market rates from falling did not, in 1962, include having any significant effect in altering the flows of private capital, even though the line of action may have had very important effects in holding a dam against an increase in the net outflow of private investment and loan funds.

3. Finally, I shall recapitulate the various sources from which the 1962 payments deficit was financed, and compare them with the financing of the 1961 deficit. In both years the gold drain was about $0.9 billion. Net of the increase in our foreign convertible currency holdings, the drain was about $0.9 billion in 1962 and $0.75 billion in 1961. In both years foreign governments prepaid long-term debts in an aggregate amount of

about $0.7 billion. In both years private foreigners other than banks increased their liquid holdings in the United States by about $0.1 billion. In 1962 international development lending agencies increased their holdings, liquid and nonliquid, by about $0.3 billion, a somewhat smaller amount than in 1961. So far, this accounts for about $2 billion in each year.

The remaining three sources were increases in our liabilities to the International Monetary Fund, increases in foreign commercial bank dollar holdings in the United States, and increases in central bank and government holdings of U. S. liabilities. First, as to the IMF: in 1962 foreign central banks held down their reserve gains by making $600 million of net repayments in dollars to the Fund, thereby increasing U. S. liabilities to the Fund, whereas in 1961 the Fund had paid out on balance a small amount of dollars to foreign countries. Second, foreign commercial bank holdings, as I have already mentioned, went down by a few hundred million in 1962, whereas these had increased by $600 million in 1961.

The rest of the financing of our deficit, in the neighborhood of three quarters of a billion dollars each year, was provided by increases in foreign central bank and government holdings of liquid and nonliquid assets due from the United States. But in 1962 most of this was accounted for by Canada. Other countries, in the aggregate, had increased their holdings by half a billion in 1961, and increased them very little in 1962, and that all in nonliquid forms.

Looking ahead into 1963, it is hard, at this moment, to visualize very substantial amounts in any of the three items which together provided in each of the last two years a net amount over $1 billion: increases in U. S. liabilities to the IMF, to foreign commercial banks, and to foreign central banks and governments.

Chairman Martin called attention at this point to the discussion at the meeting on December 18, 1962, with regard to the formulation of the current economic policy directive. He referred to the necessity for continuing to work in an effort to formulate the directive in a manner that would be satisfactory for operating purposes and conducive to public explanation of Committee policy. It was his suggestion that during the go-around at today's meeting this problem be borne in mind. Those speaking might endeavor to be clear as to whether they were specifically recommending a continuation of current policy or a change in the direction of more ease or less ease, in the thought that this might tend to focus the Committee's thinking. The Chairman also noted that Mr. Young had suggested that at the conclusion of the go-around the Committee might want him (Mr. Young) to present a summarization of economic data, with the thought that this might be helpful to the Committee in setting a background for formulation and adoption of the policy directive. This was simply a suggestion for the Committee's consideration.

Mr. Treiber then presented the following statement of his views on the economic situation and credit policy:

> As we enter the new year, it is appropriate for us to look back over the old year and see how successful we have been as a nation in attaining our broad national economic goals of (i) maximum sustainable growth, (ii) reasonable price stability, (iii) maximum practicable employment, and (iv) equilibrium in international payments.
>
> We have done pretty well on the goal of reasonable price stability. Wholesale prices have been remarkably stable, while consumer prices have moved up a relatively small amount--about 1-1/2 points, due primarily to the increased cost of services.
>
> Business seems to be doing pretty well in absolute terms, but we are not making reasonably full use of our resources of either men or machines. Our economic growth has been good, but not as good as we had hoped and expected this time last year.
>
> Unemployment is too high. Throughout the year it has been in the 5-1/2-6 per cent range.
>
> Our poorest showing in our national goals is the attainment of equilibrium in international payments. We continue to have a severe balance of payments problem.

Looking now at the present scene, the business situation has changed very little since the last meeting of the Committee. Business sentiment continues to be clearly better than a few months ago. Economic activity in the fourth quarter as a whole will apparently be appreciably above the third quarter performance--chiefly as a consequence of higher consumer purchases.

Preliminary balance of payments statistics for December show a large surplus, resulting entirely from extraordinary receipts from foreign governments which, in turn, represent for the most part advance payments for military purchases and the repayment of debt. The latter, of course, represents a liquidation of some of our official foreign assets. As a result of these special transactions, the 1962 deficit is likely to have fallen below the psychologically important $2 billion mark. But, excluding these and other special transactions, our balance of payments for 1962 as a whole does not appear to show any improvement from 1961.

Bank credit has been expanding while bank liquidity has continued to be adequate. At this time, it seems to me that easier credit is unlikely to be effective in promoting growth and employment. But easier credit and a reduction in interest rates could bring about capital outflows and aggravate our balance of payments problem.

As we enter a period in which traditionally the banking system gains reserves and consequently the Federal Reserve seeks to absorb reserves, we find that dealers' inventories of U. S. Government securities are still quite large. But the corporate demand for such securities is very strong. A firmer tone in the money market in recent weeks has helped to offset the easing in Treasury bill rates that customarily occurs at this time of the year. Most elements in the market have concluded that Federal Reserve policy has moved toward slightly less ease and is directed particularly toward avoiding a decline in short-term rates.

In the coming weeks there will be several Presidential messages and proposals for legislation. When the nature of the proposals and the Congressional reaction to them becomes known, there should be some clarification of the fiscal outlook. Until that clarification, it is especially hard to take a longer run look at monetary policy. Indeed, the frequent Treasury financings now scheduled over the coming weeks counsel an even-keel policy over the next several weeks.

I suggest a continuation of present open market policy, which calls for a continuation of open market operations to maintain the somewhat firmer tone that has existed in the money market in recent weeks in order to avoid a decline in short-term rates. I would not suggest any change in the discount rate. While some minor technical changes in the directive may be appropriate, I would not want to see any change of substance.

Mr. Ellis stated that the consumer sector was the brightest spot in the New England economic picture. Christmas season sales at District department stores were 5 per cent above the year-ago level, this being consistent with the pattern of personal income in the region, which had shown an increase of more than 6 per cent during 1962. However, this growth pattern did not show up in other economic indicators. Flows of orders to manufacturers stabilized last fall, as did aggregate manufacturing output. Member banks continued to experience a rapid influx of deposits, particularly in the time category. Loan extensions tapered off during December, so the banks added to their portfolios of Government securities, particularly short-term maturities, and they had swung to a position of net sellers of Federal funds as the year ended. At the end of November, deposits of regularly reporting mutual savings banks were substantially above the year-ago level.

Mr. Ellis expressed the view that open market operations during the past three weeks had been quite appropriate. He noted that the expansion of loan demand had continued, along with expansion of the money supply, and required reserves against private demand deposits were above the so-called growth guideline. At the same time there had been a strengthening of short-term rates, consistent with the objective of maintaining a firmer tone in the money market during a period when there was a seasonal tendency for short-term rates to weaken. The recent reduction of the Bank rate in England, which followed a reduction of the Belgian discount rate, should be helpful in connection with the problem of short-term rates and capital outflow.

Mr. Ellis noted that today's auction of Treasury long-term securities suggested the desirability of maintaining an even keel in System policy; in his opinion that financing should not be complicated by a shift in policy. As he saw it, a further expansion of required reserves against private demand deposits at an annual rate of about 3 per cent could be accommodated within a policy posture that involved a target of around $300 million for free reserves, a Federal funds rate usually at 3 per cent, and a short-term rate usually between 2.80 and 2.90 per cent. Within such a pattern, it would seem likely that the Committee's objective of preventing an excessive flow of funds abroad also would be enhanced.

Mr. Ellis felt that this kind of program could be accomplished during the next three weeks within the context of the present policy directive. However, the Committee would have to rely on a special interpretation of the clause "if necessary, through maintaining a firmer tone in money markets". As he recalled, that phrase had been included in the directive in the sense of referring to money market conditions that had prevailed during the weeks preceding the December 18, 1962, meeting. If the phrase were retained, that would infer that the Committee desired a still firmer money market tone. Accordingly, he would suggest substituting "if necessary, through maintaining the firmer tone in money markets."

Mr. Ellis indicated that he saw no reason to change the discount rate at this time.

Mr. Irons said that in the Eleventh District there had been some signs of moderate improvement during the past three weeks. Broadly speaking, however, there had not been much change; the District continued to operate at a high level of activity, but without much further advance. The index of industrial production was up slightly; crude oil production was unchanged; and the agricultural situation was generally satisfactory, with cash receipts from farm marketings running about the same as a year earlier. Construction activity continued very favorable. Employment kept inching up, but unemployment rose from 4.6 to 5 per cent during the latest month for which figures were available. Consumer buying was strong, with Christmas sales up about 4 or 5 per cent.

Loans and investments of Eleventh District banks were up, along with deposits, with the measurement of increase depending somewhat on whether one used December 28 (condition report date) or December 31 figures. Demand deposits were up slightly, while time deposits were up rather substantially. District banks continued to be net purchasers of

Federal funds. Member bank borrowing showed some gyrations at year end but otherwise remained at a modest level, with the borrowing mostly by a few country banks.

Turning to policy, Mr. Irons said that in view of Treasury financing operations, and also from the economic standpoint, he would recommend continuing the degree of firmness--or less ease--in money markets that had prevailed during the past three weeks. The System would have to absorb a substantial amount of reserves during the next three weeks, but that would not call for a deviation from the policy that the Committee had been following, which he would describe as a drift toward a little firmer money market situation.

Mr. Irons concluded by saying that he would not change the policy directive. He was not disturbed by the point mentioned by Mr. Ellis, since he would be willing to drift toward a little firmer market situation. He would not change the discount rate at this time.

Mr. Swan said that fairly complete November figures and scattered December figures indicated some moderate further improvement in the Twelfth District by the end of the year 1962. Department store sales set a new record for the month of December, while auto sales were extremely high in November and were well maintained in early December. Lumber orders, after declining in November, increased more than seasonally in December and ran ahead of production. Steel production rose in December in contrast to a decline nationally. Oil refining also increased, although no more than seasonally.

Turning to District banking developments, Mr. Swan said that the major banks had been rather substantial net purchasers of Federal funds recently and expected again to be net buyers in the current week. It appeared that the loan increase in December turned out to be somewhat larger than had been anticipated at the beginning of the month. The increase to 4.8 per cent in the dividend rate on share accounts at savings and loan associations had become practically universal in California. In view of this, the institutions previously at 4.8 per cent were emphasizing certain other features, and one had increased its rate to 4.85 per cent. Other associations were advertising that dividends would be cumulated monthly instead of quarterly or announcing that they would credit dividends from the date of deposit, or even from the first day of the month in which a deposit was made by the 20th. He mentioned these developments simply to suggest the intense degree of competition within the savings and loan industry.

As to policy, Mr. Swan noted that there appeared to have been no fundamental change in the business situation. Accordingly, and in view of the Treasury financing program, he saw no basis for any particular change in policy over the next three weeks. In other words, he would suggest the maintenance of an even keel. However, he had some question about the meaning of "no change in policy" at this particular point. As he understood it, forces operating in the past few weeks were such that the relationships in that period between free reserves, total reserves, the bill rate, and so forth were rather unusual and were not likely to continue. In particular, he strongly doubted whether, with free reserves a little over $200 million, another period of average member bank borrowings high as $700 million to support an increase in total reserves could be expected. In his opinion, a somewhat higher level of free reserves would probably be necessary to maintain the same tone in the market.

Mr. Swan commented that he was not too concerned about the fact that the bill rate had gone up a few points. Nevertheless, he hoped that the offsetting of any seasonal easing in bill rates would not necessarily mean a continuing upward push. The December 18 directive called for operations with a view to offsetting the anticipated seasonal easing of Treasury bill rates, if necessary through maintaining a firmer tone in money markets. He had the impression that perhaps this had been reversed, that operations had been conducted more with a view to maintaining a firmer tone in money markets than to offset any seasonal easing in the bill rate. He would favor a bill rate around 2.85 per cent and did not see much reason for going significantly above 2.90 per cent.

Mr. Swan commented that he would not change the discount rate at this time. As to the policy directive, he agreed with Mr. Ellis that it should not call for a still firmer tone in money markets. Also, he had some question about the "anticipated" seasonal easing of Treasury bill rates and would suggest changing "anticipated" to "any."

Mr. Deming reported that the Ninth District closed out 1962 in fairly good fashion. Department store sales apparently set a new record in December, member bank demand deposits were slightly ahead of a year earlier, and time deposits were up 25 per cent. At city banks, time deposits were 51 per cent larger than at the close of 1961. Employment was down seasonally, perhaps a shade more than seasonally, but continued about 2 per cent above a year earlier, and unemployment, except on the iron ranges, was significantly improved. November personal income ran 9 per cent ahead of year-earlier figures, and it was estimated that full year 1962 personal income was 7 per cent higher than that of 1961, a better gain than was registered nationally. Industrial power consumption in 1962 ran 9 per cent ahead of the preceding year. The Ninth District economy, therefore, began 1963 in a relatively favorable position.

Turning to the national economy, Mr. Deming said he saw 1962 as a pretty good year, registering the best gain over the previous year since 1959 and significantly better in performance than either 1960 or 1961. In point of fact, American performance in terms of national product and industrial output in 1962 relative to 1961 seemed to compare favorably with Western European performance, and in terms of price stability was far better. The blemishes on the American record were partly illusory, in that results fell short of hopes--but partly real, in that gains over the previous year narrowed as the year advanced, resources continued to be underutilized, and so little progress was made toward solving the balance of payments problem.

The 1963 forecasts seemed to point to a continuation of this slower rate of gain, which implied continued underutilization of resources, both men and machines. There might be some consolation in the 1962 balance of payment figures when they were published, but it seemed to him there was little reason to view this problem with any optimism. So, as he saw it, 1963 was beginning with about the same set of problems that had caused concern in 1962.

Actually, in Mr. Deming's view, the System had dealt fairly well with these problems in 1962. It seemed to him that the course of credit policy was correct, the results reasonably satisfactory, and the contribution to growth with stability a real one. Therefore, he saw no good reason to make any significant change in the course of policy until and unless the problem mix changed significantly. By this, he meant that policy should continue to be basically easy but cautiously so because of potential capital outflows. At the same time, preoccupation with potential short-term capital outflows should be avoided if the international payments problem moved more, as it seemed to be moving, toward a current account problem with the additional overtones of long-term capital outflows.

With respect to current policy, Mr. Deming said that he found himself in a somewhat awkward position. The Treasury financing alone argued against a change in policy. But even abstracting from this, he must say that despite having voted against the directive at the December 18 meeting, he was reasonably well satisfied with the handling of the Account during the past three weeks, complicated as the situation was by year-end movements. He would have preferred to see less borrowing from the Reserve Banks, but this seemed to have reflected commercial bank errors about as much as anything. Yet he thought it would be well to watch member bank borrowing; the errors of the banks in estimating their needs might indicate that the banking system was somewhat less liquid than the conventional statistics made it appear. On balance, however, he found it difficult to quarrel with policy implementation over the past three weeks. If this was all that the policy shift implied, he would not oppose it this time as a matter of principle, aside from the even keel aspects of the situation. But he would not like to see a further movement toward less ease under present circumstances, and he would not like to see a regularly higher level of member bank borrowing.

Mr. Deming concluded by commenting that he would be satisfied to keep the directive as it stood, and he would not change the discount rate. He would recommend, in brief, no change in policy at this time.

Mr. Scanlon said the general attitude of Seventh District businessmen was that the trend of business in the first half of the current year would be, at best, only moderately upward. Any projection of a pronounced rise in the economy in the second half of 1963 was predicated on a sizable tax cut of the "right" kind.

Labor markets continued sluggish. Department store sales were 7 per cent above the preceding year in the five weeks ended December 29, a somewhat better showing than for the nation. Savings at commercial banks and savings and loan associations continued to rise in November and December, although not quite so rapidly as in August and September. Now that holiday influences had passed, it appeared that steel production had started to rise again. For 1963 as a whole, industry sources in the area believed that steel output would exceed 1962 output slightly.

Auto sales and production declined somewhat in December but still were at high levels. Inventories at year end were slightly over 800,000, about the same as a year earlier. Production schedules for January were said to call for 696,000 cars. It now appeared that the sales-production mix would be measured to provide a million unit inventory for the spring selling season.

Construction contracts were very large in November. The Midwest enjoyed a gain over November 1961 of 12 per cent, compared with a 6 per cent rise for the nation. It should be remembered, however, that for the first eleven months of the year contracts in the Midwest were up only 3 per cent compared with a rise of 11 per cent for the nation.

Banks in the Seventh District reported a strong loan growth in December, with all loan categories sharing in the gain. Both business and consumer loans rose more than in 1961, contrary to the experience of the United States as a whole. District banks also increased their holdings of Treasury bills. Chicago banks did not feel the reserve pressure that was apparent in New York prior to the year end, although they covered a larger part of their deficit position at the discount window than at any time in recent months or at the same time a year ago.

Mr. Scanlon noted that while year-end strains made interpretation of current trends difficult, there appeared to be fairly strong credit demands from both the business and consumer sectors, and substantial monetary expansion. At the same time, with the recent reduction in British Bank rate and with the U. S. bill rate at current levels, there would seem to him to be no immediate need to press for a further increase in short-term rates. The market appeared to be convinced that the System had moved to a less easy policy. It evidently had been expecting somewhat lower long-term rates on the assumption of a continuing ease in policy, and the interpretation of current policy might have important psychological effect in this sector of the market as well as on the usual seasonal movement in the short-term sector. Since the Committee chose to adopt a policy of less ease during the past three weeks and the present position had now been arrived at, he would be hesitant to make a change at this time. Like Mr. Deming, he would prefer to stay on even keel.

Mr. Scanlon believed the current policy directive was appropriate for the next three weeks, and he indicated that he would not change the discount rate at this time.

Mr. Clay commented that the Committee continued to be faced with the dual problems of an unsatisfactory performance by the domestic economy and the persistence of an adverse position in this country's international balance of payments. The domestic economy showed very little expansionary tendency. In fact, the only sector of the private economy that had shown any marked increase in recent months was the automobile industry, and further expansion in that sector in the months ahead did not appear highly probable. Government outlays constituted the principal area in which expansion could be expected. For most other parts of the domestic economy there appeared to be an inclination to hope that improved sentiment would facilitate an upward movement, and that for business capital outlays improved sentiment plus the tax credit and accelerated depreciation allowances would avert a projected downturn.

Under these circumstances, it was rather difficult for Mr. Clay to perceive how any appreciable lessening of monetary ease would fail to have an adverse impact upon the domestic economy. The more marked changes in some measures of monetary expansion in the later months of 1962 should be viewed, he felt, as results that were appropriate to the existing economic situation and presumably should be sought by monetary policy. As the performance of the economy continued unsatisfactory, it could not be assumed that the role of monetary policy could now be lessened, as though its job somehow had been accomplished.

The adverse international balance of payments problem persisted, however. The Committee had a responsibility to do what it reasonably could to be of assistance toward keeping the problem manageable, but again it must be recognized that the Committee also was faced with very real limitations as to what it could contribute to the solution of the problem.

Mr. Clay went on to suggest that a shift in policy of the degree decided upon at the previous meeting of the Committee could not be said to be of great significance in itself for the welfare of the domestic economy. Neither could it be said to be of great significance to the condition of the international balance of payments. It was when one viewed the step as a possible move toward a basic change in monetary policy that its importance had to be carefully weighed, particularly since there was still a question as to whether the domestic economy might not need the stimulus of added ease instead.

For the period until the next meeting of the Committee, Mr. Clay felt that the dominant short-run consideration was the downward seasonal pressure on short-term interest rates. In his opinion, the Manager of the Account should be authorized to deal with these seasonal pressures in the same manner as had been indicated at the December 18 meeting.

Viewing this short-run posture as a step toward a more basic shift in monetary policy was quite another matter, however, and this would need to be considered on its own merits.

Under the circumstances, and considering Treasury financing, Mr. Clay concluded that for the next three weeks there should be essentially no change in the degree of ease. Also, there should be no change in the Reserve Bank discount rate. In the directive he would modify, as Mr. Ellis had suggested, the clause "maintaining a firmer tone in the money markets."

Mr. Wayne reported that Fifth District business began the New Year at about the same pace that characterized the final months of 1962. However, sentiment among respondents to the Reserve Bank's survey shifted significantly in the past three weeks. Businessmen had lost some of their pre-Christmas optimism, while the consensus of bankers had moved all the way from strong optimism to slight pessimism. There was some justification for the change. Seasonally adjusted textile man-hours declined in November for the sixth consecutive month, and textile respondents in the Bank's latest survey reported further recent reductions in new orders, employment, and hours. Contrary to most published reports, textile respondents indicated a slight softening of prices, which might be seasonal in nature or might reflect only limited segments of the broad textile market. Lumber producers in the survey also reported declines. (Factory orders other than textiles were reported unchanged or slightly lower following a period of gradual improvement.) Thus a few manufacturing areas, and mining, remained sources of uncertainty. Furniture makers, however, indicated a continuation of activity at record levels. Gross loans at District weekly reporting banks staged a strong December rise, exceeding all recent years except 1961.

On the national front, it seemed to Mr. Wayne that there had been no significant change in the pace of business activity in the past month. During the last ten days before Christmas there was apparently an upward surge in retail sales which may have carried them slightly above the previous high for the season, but it appeared now that the increase was little, if any, greater than the increase in population during the year. Elsewhere, it seemed that for the last quarter of 1962 most major indicators would show the smallest quarterly increases since the upswing began almost two years ago. Thus the substantial psychological boost afforded by the Cuban incident had not as yet been reflected in the data on economic activity. As the economy headed into the New Year, there was little statistical evidence of any significant changes one way or the other, so the best prospect would seem to be a continuation for some weeks at the present rather high level of business activity.

Mr. Wayne went on to say that the principal new element introduced into the policy equation since the previous Committee meeting was clearly the reduction last week in the British Bank rate. Considering the present high degree of liquidity in the economy, he saw no domestic benefit in allowing U. S. bill rates to follow the Bank rate downward. Indeed, such a course might well involve some hazard in view of the unsatisfactory state of the U. S. payments position and the continuing sizable yield spread in favor of Canada. He was increasingly convinced that it might be desirable, at this stage, to seize opportunities for allowing covered yield spreads in favor of this country to develop rather than to be content with remaining on the defensive as regards capital outflows. For his part, he would like to see bill rates maintained in the 2.85-2.95 range, irrespective of likely yield reductions abroad. He believed this range was consistent with the latest directive and with even keel considerations. In view of the strong seasonal factor ahead, the probability of further liquidation of dealer inventories, and other influences, he doubted that free reserves would be a reliable indicator in the next three weeks. He would prefer to trust the Desk's "feel" of the market in maintaining about the same tone prevailing since the last meeting. He would favor renewing the directive and leaving the discount rate unchanged. In summary, he would recommend no change in the degree of firmness that had prevailed during the past three weeks.

Mr. Mills said he would admit to being confused as to how an effective and constructive monetary and credit policy could be developed at this particular time. He put the blame for his confusion on past policy actions that had tended to peg the interest rate structure and create an artificial money market situation. A smoke screen had been thrown up to obscure monetary vision and the ability to develop policy out of observable facts. With the New Year and the opportunity for making good resolutions, he hoped the Open Market Committee would get back to fundamentals and shape its policy decisions on judgments of credit availability developed out of free market principles.

Mr. Mills thought, as he looked back through the mist of the recent past, that there had been excessive credit availability in the second half of November and through December. He felt that possibly the situation needed correction and was susceptible of correction in the first month of the New Year, when it was customary and necessary to withdraw reserves. It was easier, in his opinion at least, to adjust mechanically the sought-after degree of credit availability by withdrawing reserves than on those occasions when that objective is sought after by supplying reserves. Therefore, assuming that reserves would be withdrawn to a reasonable extent in the next three weeks, the question came up as to what degree of credit availability would develop out of those withdrawals. Broadly speaking, the sought-after credit availability would be gauged by the observable legitimate demand for bank credit. Whether that demand would produce a level of free reserves of $300 million or less, he would not venture to say, and he did not see how anyone else could make a prediction along that line.

He was fearful, Mr. Mills said, that the Committee might allow itself to be deluded into making excessive efforts toward producing some desired interest rate level out of balance of payments considerations. Not to criticize the Account Manager, because his actions were consistent with the policy directive, but where $94 million of reserves were withdrawn as against a projected level of free reserves for the current week of $385 million, he would assume that interest rate considerations were the predominant element in the Manager's decision rather than credit availability.

Mr. Mills said that he would not favor changing the discount rate at this time. He believed the Committee would be better served if the policy directive were revised to eliminate the second paragraph completely. In his opinion the first paragraph was consistent with the kind of policy favored by the discussants thus far around the table this morning, and everything needed was contained in that paragraph.

Mr. Robertson presented the following statement:

> It seems to me that we are moving into a period in which we will have an expanded area of maneuver for monetary policy, and I think we ought to be prepared to take advantage of it.
>
> I do not see any basis for reduced concern over domestic economic prospects. Business activity continues to lag well behind our potential, and there are no signs of incipient inflationary developments which would justify our going slower in efforts to stimulate a more vigorous business pace.
>
> In the international arena, however, there have been a succession of developments which seem to me encouraging. The balance of payments data for November and December look better, and interest rates in some competing foreign markets have moved down, partly as a result of official actions.
>
> I am struck by a similarity in the predicament faced by the monetary authorities in each of the three major countries

among which we ordinarily see large flows of money market funds. Canada, Great Britain, and the United States are all trying to stimulate domestic economic growth but feel inhibited in their monetary policies by the possibility of sizable capital flows.

One could see this in the British Bank rate cut of last Thursday, and the statements that accompanied it (which suggested the lower rate was aimed more at domestic credit conditions--while reserving to the Bank of England the right to charge a higher rate to discount houses to encourage a higher level of bill rates for international purposes).

If our money markets should now become sufficiently attractive to draw some funds away from Britain, we would gain a few dollars' improvement in our balance of payments position at the expense of a serious risk to the other key currency. On the other hand, if we were now prepared to follow up the British and Canadian initiative with more easing action of our own, all three economies might be able to move in step toward more stimulative monetary policies with a minimum risk of setting off adverse capital flows.

I recognize that the Treasury financing schedule is such as to require that, having tightened up on policy at our last meeting, the Committee should not again change direction for another week or so, at least. However, the sharp bank credit expansion that occurred in late December should not be accepted as an argument against an easing of policy at the appropriate time. I suspect much of that expansion was temporary, and I think we should watch the reserve statistics closely to guard against an overrapid contraction during January. During the next three weeks, the Manager of the Account should take particular care to avoid settling into a "bill-rate-only" policy. Actions should not be taken to tighten marginal reserve positions simply in order to resist bill rate declines. Such actions would risk an acceleration of monetary contraction at home as well as a prejudicial effect upon the reserves of our foreign friends abroad--a risk that is not warranted in the light of the present size of capital outflows and the current laggard pace of our own economy.

Mr. Shepardson said it seemed to him that the action of the Committee at the December 18 meeting had been implemented in line with the anticipations of those who voted for the policy directive. In his opinion the operations had been constructive, and he saw no reason for a change in policy at this time, particularly in view of the Treasury financing program. If anything, however, he would tend to drift in the direction of slightly less ease. He saw no reason to change the policy directive.

Mr. King recommended trying to continue the course that had been set during the past three weeks.

Mr. Fulton said that the sudden advent of winter weather in the Fourth District had played havoc with the reliability of normal seasonal adjustments, which were attuned to more gradual changes. If liberal allowance was made on this account, District business activity seemed to have held up well in December.

Companies making components for autos, trucks, and off-highway equipment reported a continuation of a high level of production, as did auto assembly plants. Auto manufacturers maintained that 1963 would be as good a year as 1962, though informed opinion of others than the manufacturers projected domestic production at 6.2 to 6.4 million cars. Auto sales in the District eased moderately in December, due in part to bad weather, but they were still quite brisk for the season. It was stated that one large manufacturer of compact autos would change its method of manufacture with the 1964 models. Instead of a body and frame of galvanized sheet, welded together, it was planned to use separate frame and body construction of plain sheet, but of heavier gauge. No estimate was available of the difference in tonnage of steel that might be involved in this change.

Steel production was due to pick up in the first quarter of this year. Shipments in December were low due to bad weather and the reluctance of users to take any steel into inventory over the year end. Steel buying was on a hand-to-mouth basis, with users maintaining minimum inventories. There was an expectation of some inventory building, however, especially if the wage agreement was reopened and talks were protracted. Imports of foreign steel were still quite a factor in some products. Both Japan and France had been accused of dumping, and if such charges were proved tariff increases would be made on pipe and wire to equalize the price at which steel was sold domestically by the foreign company and the price charged to U. S. customers.

Orders for metal-forming tools showed strength, but the order and backlog situation was disappointing for metal-cutting tools. Foreign orders had been declining since May. There was some indication, however, that the new depreciation schedules might encourage the buying of equipment for modernization. This had begun to show up in orders for electric welders; November orders from farm equipment manufacturers and auto makers were very good.

As to construction, there had been a sharp fourth quarter recovery, on a seasonally adjusted basis, in both residential and nonresidential contracts, but the year-to-year percentage change was below that for the country as a whole. Bad weather had resulted in a sharp rise in insured unemployment in December, cancelling out the less-than-seasonal increase in the preceding two weeks. It was believed however, that this situation would reverse itself. Department store sales recovered quickly when the worst of the bad weather passed and Christmas approached. For the week ended December 29, sales were up 33 per cent; for the year 1962, sales were 4 per cent over 1961.

The increase in bank loans at Fourth District weekly reporting banks during the fourth quarter of 1962 was the largest in the past four years, and total investments also expanded. The banks were actively seeking loans, although construction loans were being scrutinized carefully due to the number of new and unsold houses on the market.

Mr. Fulton expressed the view that the Desk had done a good job in interpreting policy during the past three weeks. He felt that free reserves in the $300-$350 million range were appropriate to achieve a desired market tone, but he would not object to a somewhat lower level of free reserves depending on the tone of the market. He had been concerned about the decline in long-term rates, and it was his feeling that a trend toward higher long-term rates would be desirable. Such a trend could discourage funds from going abroad, slow down foreign borrowing in the United States, and encourage domestic corporations to put into effect plans to borrow for plant and equipment. In all, he concluded that it would be beneficial both to the balance of payments and the domestic economy.

After commenting that he would recommend no change in the discount rate, Mr. Fulton said that in view of the general optimism of businessmen and investors and the undeniably high, though stable, level of business activity, he felt that the reference in the first paragraph of the policy directive to the "unsatisfactory level" of domestic activity was inappropriate. Therefore, he would substitute a reference to the "modest progress of the domestic economy during 1962." In the second paragraph he would eliminate the reference to the "anticipated" seasonal easing of Treasury bill rates, and he would call for the maintenance of a "firm" rather than a "firmer" tone in money markets.

Mr. Bopp said that, looking back on 1962, it was clear that a mild decline in economic activity had been under way in the Third District since the middle of the year. The first evidences of the drop were declines in the demand for labor. In the autumn output leveled off, employment began to decrease, and unemployment rates crept up a bit. These declines took place earlier than, or coincidential with, national movements. With this in the foreground of the economic picture, against the background of a relatively sluggish national economy, he had favored as much monetary ease as possible in the light of the external problem.

Moreover, banking data for the Third District indicated that ease could have considerable effect. Loans and deposits expanded considerably during the year, and in recent weeks had increased substantially further.

In Mr. Bopp's view, the domestic economy continued to call for ease. He recognized that the current Treasury financing ruled out a return to the conditions of ease prevailing before the December 18 meeting; otherwise, he would like to see such a step taken at an early opportunity. Looking ahead for the next few weeks, it was possible that the reduction in the Bank of England rate might make it less necessary to hold U. S. short-term rates at present levels. Should optimism in business sentiment wear off in February's gloom, he would favor reversion to a somewhat easier policy at a strategic moment between Treasury financings. For the time being, however, he would make no change in the discount rate, in open market operations, or in the directive, except for the changes suggested by Mr. Ellis and Mr. Swan.

Mr. Bryan said the Sixth District seemed to have ended the year rather strong. He could not prove that statement statistically, but it reflected conversations with various people in the District. Most of the available statistics were of stale dates, but there had been some increase in manufacturing employment. Also, bank debit figures were up sharply. The District, however, did not seem to be behaving in significantly different fashion from the national situation, which appeared to be one of very slow growth. The economy had ended the year on a somewhat optimistic note, occasioned chiefly in his opinion by the negative consideration that the economy had not fallen through the floor in the manner that so many people expected at mid-year after the stock market break. A second factor that caused him to be rather optimistic at the end of the year was the behavior of financial series, especially since August.

At the moment, Mr. Bryan said, he was not sure what policy recommendations would be most appropriate. The 3 per cent growth guideline in required reserves against private demand deposits was being exceeded. The year had ended with required reserves up and, although he was told that they would retreat, he was not quite so certain. He did not know how to arrive at any quantitative direction at the moment, so he would not attempt to express any direction in quantitative terms. More generally speaking, he would come out with the conclusion that the System ought to provide or offset reserves for seasonal movements, insofar as they could be determined, and perhaps provide for some additional slow growth in reserves. He would not debate whether that should be 2 per cent or 3 per cent on an annual basis.

In a concluding observation, Mr. Bryan referred to the comments that were heard repeatedly about the underutilization of manpower and plant capacity. It should be borne in mind, he thought, that an element of national policy involved the deliberate pricing of unskilled labor out of the market. In this country, by means of unemployment insurance and relief payments, the unemployed could actually live better than employed workers in other countries of the world. As long as this national policy continued, he believed that unemployment rates were destined to remain, for long periods of time, much higher than the 4 per cent level.

Mr. Shuford observed that economic developments at the national level had been covered quite fully. The situation could be summarized as one of no significant change. The same kind of condition prevailed in the Eighth District. If anything, the situation was perhaps not quite so encouraging as indicated by the reports from some of the other districts. Employment had not increased to any extent, while unemployment had increased a bit. Construction activity continued at about an even pace, perhaps a little below the level at the middle of last year. In summary, while District activity continued at a fairly high level, it showed no signs of significant improvement. If anything, it appeared that developments were slightly on the pessimistic side.

Mr. Shuford said that he tended to agree with Mr. Bryan's observations about national labor policies. Nevertheless, although policies for which the Federal Reserve did not have responsibility might operate in various directions, it was necessary to formulate monetary policy in the best manner possible. He continued to believe that the System should be as helpful as possible in stimulating the total demand for goods and services, at the same time bearing in mind and placing appropriate emphasis upon the balance of payments situation. Thinking in terms of longer range objectives, that is, for the period extending beyond the next three weeks, he would favor some further increase in bank reserves and in the money supply. For the next three weeks, in view of Treasury financing, it was his conclusion that there should be no change in existing policy. He would not want to see any steps taken specifically to raise the short-term rate from present levels.

Mr. Shuford concluded by saying that he felt that the Committee could operate satisfactorily in the forthcoming period under the present directive. He would not change the discount rate at this time.

Mr. Balderston said that in view of the Treasury financing program he thought the policy followed during the past three weeks should be continued for the coming three weeks. He was glad that Mr. Bryan had invited the Committee to look beneath the familiar statements with regard to unused human resources. Similarly, it was his feeling that plant capacity, as measured in this country, included a great deal of equipment that was inefficient and could not be regarded as competitive. As Mr. Bryan had pointed out, there was a heavy concentration of unemployment among the inexperienced and the unskilled. Relating this to monetary policy, the Committee should not deceive itself into believing that a saturation of reserves, if provided by the System, would necessarily provide jobs now or in the years just ahead for the inexperienced and the unskilled.

Going on to another point that had been of concern to him, Mr. Balderston suggested that the Committee should watch closely the rate of increase in required reserves behind private demand deposits, which had been at an annual rate of over 9 per cent during the August-December period. It would be difficult for the Committee to judge exactly what was happening during the current period until the figures settled down, but the August-December rate of increase in required reserves was not one that should continue indefinitely. Consequently, at the end of the forthcoming three-week period the Committee should be prepared to take a realistic look at the situation.

Chairman Martin commented that maintenance of the status quo for the forthcoming three-week period was obviously the prevailing sentiment within the Committee.

Continuing, the Chairman said he would not take the time to discuss again his position that the Federal Reserve had been contributing about all it could to the furtherance of the domestic economy through monetary policy, in circumstances where it was also necessary to keep a close eye on the international situation. However, he would like to comment briefly on current developments. Within the near future, he noted, the Congress would receive three principal messages from the President, including the budget message for fiscal 1964, which might include figures that would lead to a great deal of discussion. It was his understanding that even without a tax cut the deficit foreseen for the fiscal year 1964 was likely to be substantial, so substantial in fact that a considerable feeling might arise that Government spending must be watched closely. Also, in the absence of a significant decline in business, sentiment against a tax cut might well develop.

In all the circumstances, Chairman Martin said, he thought the posture of the System was quite good at the moment. It could not be said that the Open Market Committee was currently pursuing a sufficiently less easy policy to be collapsing the domestic economy. In fact, if policy were not in its present posture, it might appear that the System had thrown caution to the winds.

There would be an opportunity, the Chairman continued, to re-evaluate developments at the next Committee meeting. Among other things, it must be kept in mind that factors such as those he had mentioned in connection with the budget would have repercussions on the thinking of parties abroad. Mr. Robertson had made a good point, he added, about Britain and Canada having problems similar to those being encountered in the United States. While he (Chairman Martin) did not agree with Mr. Robertson's policy conclusions, such factors deserved consideration.

The Chairman repeated that he thought System policy was on essentially the right track. He hoped the System would be able to evolve a policy that would be clearer to the public than in the past. This got into the problem of the policy directive, with which the Committee must continue to struggle.

With further reference to the problem of the directive, Chairman Martin commented that he was not sure that the December 18 discussion had been too satisfactory in terms of offering solutions. He went on to say that Mr. Young had prepared a draft of a possible directive for this meeting for the Committee's consideration. Shortly, he would ask Mr. Young to read this draft. In his (Chairman Martin's) opinion, it was a little clearer than the present directive, though the changes were relatively minor. In this connection, the Chairman referred to the difficulty involved in a procedure whereby a large group sat around the table and endeavored to hammer out the precise wording of a document like the directive. The process was time-consuming and there was a tendency for members of the group to get stuck on particular words or phrases.

The Chairman also noted that, as he had mentioned earlier, Mr. Young had prepared certain paragraphs on the background economic situation with a view to determining whether that might be helpful to Committee procedure. He would ask Mr. Young, in addition to reading the draft directive, also to explain what he had in mind with respect to the paragraphs on the economic background.

In discussing the draft material referred to by Chairman Martin, Mr. Young pointed out that the typical entry for the record of Committee policy actions, as set forth in the Board's Annual Report, was comprised of three elements. The first part consisted of a number of paragraphs summarizing in factual form the economic situation that set the background for the Committee's discussion. The second part consisted of a summary of the discussion itself, with an indication of differing views and the policy consensus, while the third part included the current economic policy directive, the votes on its adoption, and usually the reasons for dissenting votes. The directive, therefore, was read in the light of the economic setting plus the discussion that had taken place. It had occurred to him that it might be helpful at each meeting of the Committee if the Secretary were to prepare in preliminary form and present to the Committee several paragraphs comprising a factual statement of the economic background. These paragraphs might have to be revised in the light of the discussion at the Committee meeting and the preparation of the policy record entry as a whole. However, in preliminary form they could be read to the Committee just before the taking of action on the policy directive in the thought that they might help to confirm that the directive was appropriate in the light of the economic facts.

For purposes of illustration, Mr. Young then read to the Committee the following paragraphs that were intended to outline the economic setting in which today's meeting of the Committee was held:

> The latest information available on domestic economic developments again shows little change in production and employment around the levels reached in mid-year, while gross national product is estimated unofficially to have increased moderately further in the fourth quarter. Current levels of activity, although high in terms of most earlier periods, are well below those needed to utilize fully existing manpower and industrial capacity. Unemployment in December is estimated to be little changed from the advanced November rate. Department store and new auto sales in December continued high but below November levels. New orders for machinery and other equipment rose again in November. Commodity prices continued stable last month and consumer prices were unchanged in November.
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> In the financial area, yields on private and Government fixed return securities showed little net change in recent weeks. Corporate and State and local security offerings were in moderate volume in December and were indicated to continue light in January. Stock market prices in December maintained the advanced

levels reached following the Cuban crisis and in early January rose further.

Seasonally adjusted commercial bank credit in December was estimated to have increased sharply, about in line with the growth in recent months. Bank loans continued to register a substantial increase. Also, the private money supply rose sharply and time and savings deposits increased substantially further. Required reserves of member banks averaged over 3 per cent higher than in December a year ago and for the four months including December had increased at a seasonally adjusted annual rate exceeding 9 per cent. Excess reserves and borrowing both moved higher as banks adjusted their year-end reserve positions, with free reserves declining considerably and the money market continuing relatively firm. In accordance with the directive adopted at the preceding meeting, System operations during the period were conducted with a view to maintaining slightly less easy monetary conditions.

The U. S. balance of payments in the fourth quarter, apart from special receipts, was still in serious deficit, but not on a scale comparable with the temporarily very large deficit in October. Imports leveled off in November, following a steady drift-up during the year. Exports were off somewhat in the third quarter despite acceleration of shipments in anticipation of a dock strike in October. Owing to the effect of this forward shift in depressing October exports the total for the fourth quarter was probably off further. Gold and foreign exchange markets in recent weeks maintained a relative calm.

Mr. Young next read for the Committee's consideration a draft of current economic policy directive that it was thought might be appropriate if the Committee's decision was to make no change in the basic policy that had been adopted at the meeting on December 18, 1962. The draft directive read as follows:

In the light of the latest economic information reported to the Federal Open Market Committee, it is the Committee's current policy to accommodate further, though more moderate, growth in bank credit and the money supply, while aiming at money market conditions that would minimize capital outflows internationally. This policy takes into account the lack of significant improvement in the United States balance of payments and the recent substantial increases in bank credit, demand deposits, and the reserve base, but at the same time recognizes the unsatisfactory level of domestic activity, the continuing underutilization of resources, and the absence of inflationary pressures.

To implement this policy, System open market operations during the next three weeks shall be conducted with a view to maintaining about the same degree of firmness in the money market that has prevailed in recent weeks and to offsetting seasonal downward pressures on short-term interest rates, while providing for moderate reserve expansion in the banking system.

Chairman Martin commented that, as suggested earlier, Mr. Young's drafts were intended to explore possible methods of improvement in the Committee's directives and the presentation of the Committee's policy actions in the Board's Annual Report, thus following up on the discussion at the meeting on December 18, 1962. He referred to the problem involved for outside parties in reading the policy record without the benefit of the full discussion that resulted in the adoption of a particular directive. The directive might be clear to members of the Committee, but a different problem was involved in explaining it to readers of the policy record. The Committee must continue to work on methods of meeting this problem, and Mr. Young's presentation suggested one possible approach.

Question was raised whether it was the intent that suggestions would be received with a view to possible revision of both the paragraphs on the economic situation and on the policy directive itself, and it was made clear from subsequent discussion that it was intended that the current policy directive would be approved in final form before the adjournment of each meeting of the Committee. The subsequent comments of Committee members would be with a view to making appropriate changes in the factual statement. It was also made clear that it would be the intent to distribute a draft of policy record entry subsequent to each Committee meeting for the receipt of comments and suggestions in the customary manner. The paragraphs read at each meeting would be regarded as a very preliminary draft of statement on the economic situation, and the draft subsequently distributed for the Committee's comments would be prepared in the light of the entire discussion that had taken place at the Committee meeting. It was possible, for example, it would develop from the discussion at the meeting that greater emphasis had been placed on some aspects of the economic situation than on others, so that some change of emphasis in the policy record draft would be required. However, the Committee would have before it a statement of the basic facts and an opportunity to formulate the policy directive in the light of having heard those facts summarized.

Mr. Mills observed that at each meeting the Committee received oral economic and financial reports from members of the staff. Such reports contained facts on which the Committee members presumably based their judgments. In addition, the members gave consideration to the regional economic reports presented during the meeting. However, as he understood the contemplated procedure, the Committee members would have before them in the course of reaching a policy decision a statement such as Mr. Young had read, in which event it was possible that their first policy thinking might be exposed ex post facto to an altered line of reasoning.

Chairman Martin commented, on this point, that such material was not intended to supply additional information but rather to summarize what was otherwise available.

Mr. Treiber referred favorably to the statement read by Mr. Young, although indicating that he might have some comments or suggestions after he had had an opportunity to examine it thoroughly. As he understood it, Mr. Young's suggestion would contemplate that such material would be incorporated in the Committee's minutes, thus providing the Committee members an opportunity to focus on the statement in reviewing the minutes and to submit comments. Then, when the minutes were approved, the outline of the policy record entry, or at least one portion thereof, would be indicated rather clearly.

Chairman Martin responded by saying that it had been the thought that everyone could comment on the economic summary as it appeared in the minutes. Then, by the time the minutes were approved, progress would have been made on the preparation of the policy record entry.

In further discussion Mr. Mills suggested that essentially the same purpose could be accomplished through a prompt distribution of drafts of policy record entries. Mr. King asked if he was correct in assuming that a principal purpose of the procedure suggested by Mr. Young was to expedite preparation of the policy record entries, and Chairman Martin agreed.

The discussion then turned to the draft of possible policy directive that had been read by Mr. Young, and copies thereof were distributed.

Mr. Fulton repeated his earlier suggestion that in the first paragraph language stating that Committee policy "recognizes the modest progress of the domestic economy during 1962" be substituted for "recognizes the unsatisfactory level of domestic activity".

The suggestion also was made that the introductory part of the first sentence of the draft directive be eliminated on the grounds that it was unnecessary and tended to become repetitious, and there was agreement with this suggestion.

Mr. Deming stated that his only objection went more to the form of the draft directive than its substance. In explanation, he pointed out that the draft directive was worded in such a way as to indicate that it was the current policy of the Committee to accommodate further, though more moderate, growth in bank credit and the money supply. It was his thought, in line with views he had expressed at the Committee meeting on December 18, 1962, that it would be preferable if the Committee's directives were aimed at things the Committee actually could do, as in the second paragraph of the draft directive. In contrast, the first paragraph of a directive might preferably be in the nature of a "whereas" clause. For example, he would have no objection to expressing the Committee's satisfaction or dissatisfaction with the rate of growth of the money supply. On the other hand, he did not like to say that it was the Committee's policy to do certain things with regard to the money supply, over which the Committee did not have direct control. To put it another way, he felt that the instruction in the directive should be confined to specifying how open market operations were to be conducted, with reference to factors such as free reserves, the tone and feel of the market, and interest rates. As the directive was drafted, he would have no objection to the second paragraph.

There followed a review of the differences between the directive issued on December 18 and the proposed directive, and this led to further comments regarding the portion of the proposed directive that would state that it was the Committee's policy to accommodate "further, though more moderate growth" of bank credit and the money supply. Question was raised whether this language was intended to imply a more moderate growth than indicated by the December 18 directive.

After some discussion of this point, question was raised whether it would not be appropriate to adopt a directive in the same form as the directive issued on December 18, to which Chairman Martin responded that this reflected a tendency, into which the Committee had fallen at times, of resorting frequently to renewing the directive without change. He understood that Mr. Young had been endeavoring to emphasize the substantial increases that had occurred in bank credit, demand deposits, and the reserve base.

Mr. Swan expressed the view that the language of the proposed directive appropriately reflected a change from the preceding directive by calling for "maintaining about the same degree of firmness in the money market that has prevailed in recent weeks" rather than for "maintaining, if necessary, a firmer tone in money markets". Also, the proposed directive appropriately called for "offsetting seasonal downward pressures on short-term interest rates" rather than for "offsetting the anticipated seasonal easing of Treasury bill rates".

There followed a brief discussion of a possible procedural approach to the formulation of the policy directive under which a directive would be adopted in substance by the Committee and the Secretariat would then be asked to work on specific wording for final Committee approval. However, it was the unanimous view that a directive should be adopted in final form prior to the adjournment of each Committee meeting. Otherwise, it was pointed out, there might be a question about the exact nature of the instructions that had been issued to the Desk.

Mr. Ellis then suggested another possible procedural approach whereby it would be ascertained in general discussion that there was broad agreement on most parts of whatever directive was under consideration, or on certain suggestions with respect thereto, following which a vote would be called for to determine the consensus on any points as to which there appeared to be a substantial difference of opinion.

Chairman Martin noted that at a certain stage the procedure of voting on points in the directive that remained under debate might sometimes be necessary to resolve such matters. However, he continued to be concerned about the thought of taking votes on particular words. He questioned whether the kind of problem involved was susceptible of solution by such a procedure.

At the Chairman's request, Mr. Young then read to the Committee the language of the directive he had suggested, as amended to reflect the technical suggestion agreed upon earlier and the amendment suggested by Mr. Fulton.

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 execute transactions in the System Open Market Account in accordance with the following current economic policy directive:

It is the Committee's current policy to accommodate further, though more moderate, growth in bank credit and the money supply, while aiming at money market conditions that would minimize capital outflows internationally. This policy takes into account the lack of significant improvement in the United States balance of payments and the recent substantial increases in bank credit, demand deposits, and the reserve base, but at the same time recognizes the modest progress of the domestic economy during 1962, the continuing underutilization of resources, and the absence of inflationary pressures.

To implement this policy, System open market operations during the next three weeks shall be conducted with a view to maintaining about the same degree of firmness in the money market that has prevailed in recent weeks and to offsetting seasonal downward pressures on short-term interest rates, while providing for moderate reserve expansion in the banking system.

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

Mr. Mills commented, in connection with his vote, that although he had voted for the directive he would like to call attention to the part of it that expressed a current Committee policy of accommodating further, though more moderate, growth in bank credit and the money supply. He thought the experience of the past three or six weeks would prove to be abnormal and that the situation could snap back to one involving a contraction of credit. If so, critics with the benefit of hindsight might say at a later date that the Committee had deliberately pursued a harsher policy than was actually intended.

Secretary's note: Pursuant to an intent that he stated at this meeting, Mr. Robertson subsequently transmitted to the Secretary for inclusion in the minutes the following statement in amplification of oral comments concerning the basis for his negative vote on the directive:

In view of the Treasury's financing program, including the auction today of $250 million of long-term bonds, and the fact that during the past three weeks implementation of Committee policy has resulted in some growth in the money supply and total reserves for the banking system, I would have been inclined to vote today for "no change" in policy. However, in my view the policy of this Committee for the next three weeks should under no circumstance be more restrictive (or less stimulative) than the policy adopted by the Committee at the

> December 18, 1962 meeting. Furthermore, I believe that primary emphasis should not be placed on the maintenance of a Treasury bill rate, for there is inherent therein a tendency to settle into a bill-rate-only policy; actions should not be taken--pursuant to our policy directive--to tighten marginal reserve positions simply in order to resist a decline in the bill rate. Primary emphasis should be placed on the maintenance of such a volume of reserves and money supply as will stimulate a lagging economy. Since this directive seems to be inconsistent with these views, I must vote "Nay".

There ensued additional discussion regarding the directive just adopted, and the Chairman called upon Mr. Young for further comment on the part of the first paragraph of the directive that expressed the Committee's current policy of accommodating further, though more moderate, growth in bank credit and the money supply.

Mr. Young commented that for several months there had been a very substantial increase in bank credit, demand deposits, and the reserve base. If these rates of increase continued, they would result in some kind of explosion at some point. Therefore, in looking at the directive issued on December 18, which stated that it was the Committee's policy to accommodate "moderate further increases in bank credit and the money supply," it occurred to him that a change would be desirable to emphasize that further growth should be more moderate than had occurred. This did not mean, of course, that if the growth turned out to be quite moderate, the Committee would continue to press for still more moderate growth. Its objective would have been accomplished.

In reply to a question, Mr. Young said it was the intent to indicate that Committee policy would be designed to accommodate a rate of growth of bank credit more moderate than in recent months, particularly since August, in contrast to the past year as a whole.

Mr. Wayne suggested that the interpretation just given by Mr. Young would flow naturally from the economic background paragraphs that Mr. Young had read earlier.

Mr. Deming then supplemented his previous comments by expressing the view that it would be preferable to indicate in the first paragraph of the directive that the Committee was continuing to pursue a moderately stimulative program. The second paragraph of the directive would then specify in rather concrete terms what the Committee was instructing the Account Manager to do in the period just ahead. Mr. Deming brought out, by way of illustration of his point regarding the first paragraph, that the Committee did not know, in fact, just why the money supply had grown at such a fast rate in recent months. It was conceivable that a further substantial expansion in the money supply would occur.

The Chairman then called on the Account Manager for comments, and Mr. Stone said he would interpret the first paragraph of the Committee directive as a statement of the Committee's general objectives, with an indication of factors that impelled it to choose these objectives rather than others. He would understand that the second paragraph contained an instruction to the Desk on implementing, within a specified time period, the general objectives outlined in the first paragraph. He would interpret the directive, as just adopted by the Committee, as calling for operations with a view to providing for moderate reserve expansion in the banking system, as indicated in the second paragraph.

Mr. Deming then commented that, as he had previously indicated, he had no quarrel with the second paragraph. In the first paragraph, however, if the Committee's general objectives were tied to bank credit and the money supply the Committee would undertake to deal with matters over which it did not have direct control. In his opinion this problem could be met by using a phrase in the first paragraph something like: "It is the current policy of the Federal Open Market Committee to continue to pursue a moderately stimulative program while aiming at money market conditions that would minimize capital outflows internationally." Such a generalized statement would in his view be reasonable, whereas he did not like to cite as a policy objective something that might not be attainable by the Committee.

Mr. Young noted that one of the problems in having two paragraphs in the directive--one broader and one more specific--was the question of time dimensions, which in the first paragraph were longer range and in the second paragraph related to a specific short-run period.

Mr. Balderston expressed himself as having some sympathy with the point made by Mr. Deming. It was somewhat the same as the point that had been made by Mr. Knipe: that the supply of bank reserves was controlled by the Federal Reserve System while the money supply was merely influenced by the System, given sufficient time. Mr. Balderston suggested along these lines that the first part of the directive adopted today might have been somewhat simplified. He agreed that Committee policy was aimed at money market conditions that would minimize capital outflows internationally; thus, it might have been appropriate also to say that Committee policy was "aiming" at a further moderate growth in bank credit and the money supply. He was not sure that at a large meeting it was feasible to develop precise wording, but he would like to suggest that the Secretary try his hand at something along the lines Mr. Deming had proposed.

In further discussion, Chairman Martin observed that the Committee would have another opportunity at its next meeting to take a look at the form of the directive in the light of the discussion that had taken place today. Through steady work on the problem, it might be possible to achieve improvement. This all tied into the problem of explaining System policy to the Congress and the public, and the System must make every effort to do the best job.

There followed additional discussion during which certain further suggestions were made with respect to the possibility of amending the policy directive that had previously been adopted. One suggestion was to characterize the progress of the domestic economy as showing slight improvement but continuing at an unsatisfactory level. Another suggestion was to specify that it was the Committee's policy to accommodate further growth in bank credit and the money supply, although at a more moderate rate of increase than in "recent months." At the conclusion of the discussion, however, it was the consensus that the directive should be left in the form in which it had been adopted earlier in the meeting.

It was agreed that the next meeting of the Open Market Committee would be held on Tuesday, January 29, 1963, and that succeeding meetings would be scheduled tentatively for February 12 and March 5, 1963.

The meeting then adjourned.

Ralph A. Young
Secretary