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, November 12, 1963, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Bopp
Mr. Clay
Mr. Irons
Mr. Mills
Mr. Mitchell
Mr. Robertson
Mr. Scanlon
Mr. Shepardson

Messrs. Hickman, Wayne, Shuford, and Swan, Alternate Members of the Federal Open Market Committee

Messrs. Ellis and Deming, Presidents of the Federal Reserve Banks of Boston and Minneapolis, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Baughman, Brill, Furth, Green, Holland, Koch, and Tow, 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. Broida, Assistant Secretary, Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, Secretary, Office of the Secretary, Board of Governors

Messrs. Holmes, Mann, Jones, Parsons, and Grove, Vice Presidents of the Federal Reserve Banks of New York, Cleveland, St. Louis, Minneapolis, and San Francisco, respectively
Messrs. Parthemos and Brandt, Assistant Vice Presidents of the Federal Reserve Banks of Richmond and Atlanta, respectively
Mr. Clay J. Anderson, Economic Adviser, Federal Reserve Bank of Philadelphia
Mr. Paul S. Anderson, Financial Economist, Federal Reserve Bank of Boston
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 October 1, 1963, were approved.

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 October 22 through November 6, 1963, together with a supplemental report covering November 7 and 8, 1963. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Coombs commented that the Treasury gold stock would remain unchanged again this week, running the period of no change to roughly three months. The Stabilization Fund now had $83 million of gold against prospective November orders of $62 million. Some $40 million of Russian gold had been acquired by the London Gold Pool on the Friday preceding the meeting and further Russian sales seemed likely.

Mr. Coombs reported that at Basle, where he spent the past weekend, there had been much discussion of the Italian and Dutch situations. Governor Carli of the Bank of Italy had given a fairly encouraging report on the Italian problem. There had been an improvement in the political atmosphere. The outflow of funds from Italy had slowed down somewhat during the past week or two, and the Governor was hopeful that the record for November would be better than for October. Governor Carli had paid tribute to the cooperation of the Federal Reserve and the U. S. Treasury in making possible a reduction in the Italian reserve loss during October from $270 million to the actual figure of $153 million. The reciprocal nature of U. S. exchange operations had now become increasingly clear to European central bankers, Mr. Coombs said, and he sensed a growing measure of support for U. S. policy in the international financial area.

Regarding the Netherlands, Mr. Coombs reported that the Dutch government had conceded the 10 per cent wage increase demanded by labor, and the question now was whether the Netherlands Bank would have to adopt a restrictive monetary policy in order to limit the inflationary reactions. The Dutch authorities were aware that a rise in their discount rate might trigger other discount rate increases on the Continent, and probably would consult with neighboring governments before acting. Such actions as raising the discount rate or curtailing bank reserves would result in a repatriation of funds by Dutch commercial banks. However, Mr. Coombs felt the Dutch authorities would be prepared to accept guilder bonds issued by the U. S. Treasury to mop up any surplus dollars, so that action by the System probably would not be required.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period October 22 through November 8, 1963, were approved, ratified, and confirmed.

Mr. Mills asked whether the growing enthusiasm for the System's swap arrangements that Mr. Coombs had found at Basle reflected a general belief in their basic usefulness or an undercurrent of concern by European monetary authorities about their own currencies that caused them to look with favor on the additional resources the arrangements made available to them. Mr. Coombs replied that originally certain European monetary officials had been skeptical about the System's motives in undertaking the swap arrangements; there was some feeling that the System viewed them as a one-way street, designed to help the United States alone, and that once the American problem was resolved the System would back away. However, developments had tended to convince these officials that our motives were not selfish, and that we were prepared to help other nations with their balance of payments problems rather than just soliciting their help with our problem.

Mr. Coombs said that before making his recommendations he would like to mention that while in Basle he had received the impression that there was a greater disposition than formerly on the part of the Bank of France to increase the size of their swap line with the System. He felt that it might be desirable to make such an increase during the next few months.

Mr. Coombs recommended renewal on a three-month basis of the $100 million swap arrangement with the Netherlands Bank, which had last been renewed on September 13, 1963.

Renewal of the swap arrangement with the Netherlands Bank for a further three-month period was approved.

Mr. Coombs then referred to his memorandum entitled "Request for authorization of spot purchases of Italian lire, and other European currencies, and of their simultaneous forward sale to the U. S. Treasury," dated November 8, 1963, which had been distributed to the Committee in advance of this meeting. (Note: A copy of this memorandum has been placed in the files of the Committee.) In accordance with the memorandum, he recommended that the Federal Reserve Bank of New York be given authority to make spot purchases of foreign currencies in which the Treasury had outstanding indebtedness, for purposes of immediate forward sale to the Treasury to cover outstanding Treasury debt in these currencies. He proposed that this authorization be in the amount of $100 million, and include provisions that purchases could be made at rates above par and that both the spot purchases and forward sales should be made at the same rate.

In discussion, questions were raised about the implications of the proposal that these transactions be authorized at rates above par, about the desirability of generalizing the authority beyond the Italian lira, the currency with which Mr. Coombs' memorandum was most specifically concerned, and about the adequacy of the proposed dollar limitation. On the matter of above-par rates, Mr. Coombs noted that the Bank of Italy had chosen to defend the lira at a rate that was relatively high, although within the International Monetary Fund limits, and the System had to pay the rate set in order to acquire lire. The fact that the currency immediately would be sold forward at the same rate to the Stabilization Fund meant that the System would neither gain nor lose on the operation, apart from any interest earnings that accrued during the period it held the lire. The Treasury would not incur a loss--in fact, would make a profit--since the lira-denominated bonds it eventually would redeem with the lire purchased from the System had been issued at the ceiling and the rate was currently below the ceiling. While he personally felt that the Italians might have been better advised to defend the lira at a lower rate, he thought a recommendation to this effect might be construed as undue interference in their affairs, and also might be embarrassing since a lower rate would mean a larger profit to the U. S. Treasury. In Mr. Coombs' judgment the circumstance at which the recommendation was directed was a rather special one, in which the System had an opportunity to help stabilize a situation by warehousing foreign currencies without capital risk until they were needed by the Treasury, whose resources for this kind of operation were limited. The recommendation did not imply any modification of the Committee's general policy that the usual types of spot purchases of foreign currencies should be made at or below par values.

On the question of whether the authority should be confined to the lira or made applicable to all currencies in which the Treasury had indebtedness, Mr. Coombs said he had not intended to raise a matter of principle in recommending the latter. In future similar situations, he thought, there ordinarily would be ample time for him to come to the Committee for specific authorization. On the other hand, he viewed the recommended procedure simply as facilitating Treasury repayment of debts denominated in foreign currencies, and thus desirable in other cases also. He agreed with a suggestion made by Mr. Ellis that the procedure might well provide a routine channel for redeeming outstanding Treasury bonds denominated in foreign currencies, and thought that it would increase the saleability of such bonds. Mr. Coombs observed that there was another point of major importance. If a foreign currency should be devalued, he noted, the System would suffer a loss on any outright holdings of that currency, whereas the Treasury would make a profit in connection with any indebtedness it had denominated in terms of that currency. If circumstances should arise in which devaluation of a currency seemed inevitable, the System might be able to sell its holdings forward to the Treasury and thus hedge its position. While this was a matter for the future, an authorization in the general form requested would open the way.

Mr. Coombs said he thought $100 million for the proposed purpose would be adequate at present because it would be used as a revolving fund. By way of example he noted that the Treasury had $50 million in lira-denominated debt maturing in March 1964. Accordingly, if at least $50 million had been employed prior to that date for operations in lire of the type contemplated, this amount would be released at that time for reemployment.

After this discussion Chairman Martin commented that the principle of the proposed operation seemed clear. He noted that only a modest amount was involved, and he thought that the main question in the minds of Committee members was whether the authority should be limited to operations in Italian lire or made general. Mr. Robertson observed that he saw no objection to an authorization drawn in general terms. He felt, however, that the contemplated type of operation should be viewed as an experiment, to be reconsidered by the Committee as the occasion warranted.

The Chairman then proposed that the Committee vote on the recommendation, with the understanding that it was experimental and that Mr. Coombs would keep the Committee fully informed about developments.

Accordingly, upon motion duly made, and seconded, and by unanimous vote, the continuing authority directive for System foreign currency operations was amended, effective immediately, to read as follows:

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 reaffirmed by the Federal Open Market Committee on March 5, 1963, as amended May 28, 1963; provided that the aggregate amount of foreign currencies held under reciprocal currency arrangements shall not exceed $1.95 billion equivalent at any one time, and provided further that the aggregate amount of foreign currencies held as a result of outright purchases shall not exceed $150 million equivalent at any one time:

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

The Federal Reserve Bank of New York is also authorized and directed to operate in any or all of the foregoing currencies in accordance with the Guidelines and up to a combined total of $150 million equivalent, by means of:

(a) purchases through forward transactions, for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements;

(b) purchases and sales through forward as well as spot transactions, for the purpose of utilizing its holdings of one currency for the settlement of commitments denominated in other currencies; and

(c) purchases through spot transactions and sales through forward transactions, for the purpose of restraining short-term outflows of funds induced by arbitrage considerations.

The Federal Reserve Bank of New York is also authorized and directed to make purchases through spot transactions, including purchases from the U. S. Stabilization Fund, and concurrent sales through forward transactions to the U. S. Stabilization Fund, of any of the foregoing currencies in which the U. S. Treasury has outstanding indebtedness, in accordance with the Guidelines and up to a total of $100 million equivalent. Purchases may be at rates above par, and both purchases and sales are to be made at the same rates.

Noting that Mr. Young and Mr. Irons had recently returned from Europe, Chairman Martin suggested that they report their observations to the Committee.

Mr. Young said that he had attended two meetings during the previous week one of Working Party 3 and one of the Economic Policy Committee of the Organization for Economic Cooperation and Development, of which Working Party 3 is a sub-body. An interesting aspect of this Working Party 3 meeting was that, for the first time since the Working Party's origin in 1961, U. S. balance of payments difficulties were not on the agenda. Attention was focussed entirely on the inflationary developments manifest in most European countries, especially Italy. The Italians had had a balance of payments deficit in the past nine months of around $750 million, reflecting a high level of internal demand, with imports rising spectacularly and exports falling, and some flight of capital. Until October the deficit had been financed by borrowings of Italian commercial banks in the Euro-dollar market, but in October, it had been permitted to be reflected in a decline in monetary reserves. Representatives of other European countries had been sharply critical of the Italian performance, and the Italians had admitted that the situation was getting out of hand and could not continue. But they assured the Working Party that the problem was fully understood by all parties to be represented in the new government, and that each of the parties had agreed to the essential elements of a stabilization program, involving a fiscal effort, with a cutback of government expenditures, especially public investment, and some increase in revenues; a shift in practices for financing balance of payments deficits; some action to relieve pressures in the construction industry; restraint on bank credit expansion; and a policy of restraining wage increases. From now on, as had been the case in October, deficits would be reflected in the reserve position of the central bank. It was their hope that the deficit would taper off, and that by the middle of 1964 restoration of balance in payments would be in sight, if not actually achieved. The Italians asked the Working Party group to express their views on the Italian situation in writing, to help the new government crystalize its ideas on a program to bring the situation under control.

The inflation in Italy, Mr. Young continued, was now being felt by neighboring countries in various ways. Most of the increase in exports that Germany had experienced over the past nine months had been to Italy, and the same was true for France and Switzerland. The Germans and Swiss were heavy users of Italian labor, and recent increases in Italian wage rates had forced them to raise wages also. Spreading inflation was threatening to overrun Continental Europe unless comprehensive steps were taken to halt it.

There also was a report by the Netherlands, Mr. Young said, which included a declaration that they would not use restrictive monetary policy further than at present to meet their internal inflationary problems. This raised a general question of the extent to which restrictive monetary policy might be used by other countries, including France, Germany, and Italy. The consensus of Working Party 3 was that it was desirable to avoid higher interest rates on the Continent in view of the problem they would pose for the United States. This consensus was conveyed to the parent body, the Economic Policy Committee. In his report, the Chairman of the latter group said he understood that it was not the intention of the United States to press restrictive monetary policy to a point where the U. S. would be bidding through higher interest rates, for available international financial resources. Mr. Young said he sensed a feeling at the meeting that the Europeans would forego aggressively restrictive monetary policies as a means of meeting their inflationary situations and would rely more on fiscal action instead.

Mr. Irons said that he had appreciated the opportunity to participate in the meeting at Basle and to visit with bankers in various cities on the Continent. He shared many of the impressions Mr. Young and Mr. Coombs had reported. He had found substantially more acceptance of the soundness of the dollar and less expectation that it would be tampered with than he had noted on his trip of a year and a half ago.

In France, and to some extent in Germany, the Netherlands, and Switzerland, there was concern about rising wage and price pressures. These countries were still importing substantial amounts of labor. The Europeans recognized that the U. S. was becoming more competitive with them because of their wage and price increases. With regard to U. S. policies, Mr. Irons felt the Europeans were generally favorable toward the recent firming of money rates, the discount rate action of July, and other actions taken in this country over the past several months. They hoped the System would not push restrictive monetary policy to the point of putting pressure on them to drive up rates in their countries. On one U. S. proposal--the interest equalization tax--

there was almost unanimous disapproval. The Europeans felt it was an extremely complicated type of exchange control, and thought it would be better for the U. S. to use more direct methods, whether a capital issues committee, a quota system, licensing, or whatever. The Europeans thought the United States was moving in the right direction with respect to its balance of payments difficulties, and that the crisis might have been passed. This view was related to their feeling that the U. S. had become more competitive, and to their expectation that there would be some improvement in the capital movements situation.

Before this meeting there had been distributed to the members of the Committee a report covering open market operations in U. S. Government securities and bankers' acceptances for the period October 22 through November 8, 1963. A copy of this report has been placed in the files of the Committee.

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

> The past three weeks have witnessed a gradual and orderly rise in interest rates throughout the maturity scale. The fundamental influence working in that direction has been a strengthening of the market's conviction that the business outlook is undergoing significant improvement and that the System might respond, or be responding, by taking a firmer tack in monetary policy. In the short-term area, this shift in sentiment occurred simultaneously with a succession of Treasury financing operations in which the market was called upon to absorb sizable amounts of short-term issues. Either of these influences--the shift in sentiment or the addition to the supply of short issues--would alone have exerted upward pressure on short rates. In combination, they were mutually reinforcing in their impact on rates.

In the long-term sector, the shift in sentiment occurred simultaneously with a sharp bulge in new corporate and municipal bond issues--and both of these developments caught the market at a time when it still had in position large amounts of intermediate and long-term issues that the dealers had taken out of the advance refunding two months ago. Under these circumstances, bond prices fell and rates moved higher; and the heavy atmosphere that emerged in the long-term area affected, and in turn was affected by, the equally heavy tone that characterized the short-term market.

Developments within the period were sensitively reflected in the experience with the Treasury's November refunding. The terms of this exchange, in which the Treasury offered an 18-month 3-7/8 per cent note, were generally well received. Large subscriptions were entered on October 28, in some cases apparently with a view to selling out shortly afterwards with a modest price gain. The 21 per cent allotment on nonpreferential subscriptions, announced on October 31, was in line with the views generally being expressed in the market, but may have slightly exceeded the anticipations of some large subscribers. In the meantime, with general market sentiment turning increasingly bearish (as reflected and heightened by the rather unenthusiastic auction of 1-year bills on October 30), the price of the new notes moved gradually lower in when-issued trading--receding from a high point of 100-3/32 bid on October 29 to a shade under par on November 8.

In the Treasury bond market, as I noted earlier, the shift in business sentiment reinforced pressures that were already emerging because of heavier competition from increased corporate and municipal bond flotations, and both these influences converged on a market that was already restive with its holdings of intermediate and longer-term issues. Dealers managed to reduce their holdings of over-20-year maturities by about half in the past three weeks, partly in reflection of some buying by Treasury trust accounts and the System. Further progress was also made in cutting 5-10 year holdings, again partly in reflection of some official purchases. Over the period as a whole, intermediate and longer-term bonds rose by 1 to 7 basis points.

In the Treasury bill market, the Treasury sold for cash in the recent period both a $1 billion strip of bills in the 3-5 month area and a $1 billion block of 1-year bills. These offerings, which bracketed the sale of the new 18-month 3-7/8's, followed a new issue of March tax anticipation bills earlier in October. With dealers obtaining large amounts of each of these issues, their positions rose substantially within the period--in the case of bills, to well over $3 billion at one point. But their total bill holdings were receding by the end of the period and further sizable inroads were made last Friday when the Treasury trust accounts bought bills in size to offset upward rate tendencies. On the other hand, dealer awards in last Friday's auction were unusually large.

System operations during the past few weeks were complicated both by the bearish atmosphere of the securities markets and by the large reserve flows and day-to-day money market uncertainties created by the payment for two billion dollar cash bill issues mentioned earlier. Given these uncertainties, and also given the recent tendency of reserve levels to fall short of estimates, the Desk supplied reserves relatively freely over the period--meeting reserve drains from market factors as they occurred or even moving at times in anticipation of those drains so as to avoid aggravating a somewhat nervous securities market with any short-term money stringercy. Reserves were supplied nearly every day of the period, amounting to a net of almost $1 billion for the three weeks as a whole. This large injection of funds was made through purchases both on an outright basis and through repurchase agreements. Although free reserves averaged somewhat higher than in the preceding few weeks, and member bank borrowings averaged a shade lower, Federal funds were generally in firm demand at 3-1/2 per cent throughout the period.

Reserve projections for the next few weeks suggest that System operations can be more moderate than in recent weeks, and accordingly it may be appropriate to return the leeway to $1 billion from the $1.5 billion that has recently prevailed.

In response to questions by Mr. Mills, Mr. Stone said that dealers had not had difficulty in financing their larger bill inventories. A substantial volume of corporate funds had been available to them under repurchase agreements, and their borrowing rates had in fact moved down while most bill rates were moving up. One reason for this was that heavy demand had lowered rates on short-term bills--such as those with December maturities--to the point where dealer repurchase agreements were attractive to corporate treasurers. Mr. Stone did not think there was any fundamental instability in the bill market at present. The market had acted about as might have been expected under the circumstances; rates had moved up until buyers could be found for the substantial additions to bill supplies it had been necessary to absorb.

Mr. Mitchell said that he had been somewhat disturbed by operations in the recent period, and gathered that the Desk had had some uneasy days in attempting to follow the Committee's directive. He noted that while free reserves were relatively stable in the last reported week, excess reserves had risen to over $500 million and borrowings to about $400 million, and asked whether the figures on borrowings might not be a more sensitive indicator of market pressures than the free reserve figures. Mr. Stone replied that the Desk did watch borrowing figures closely, and also paid close attention to daily and even hourly developments in the Federal funds market--which developments are often a clue to the volume of borrowings that will be forthcoming. He added that the influence of the Treasury's recent bill issues, which raised new cash but did not permit payment through tax and loan accounts, had increased the difficulties of interpreting market developments. In connection with these issues there were substantial flows of funds into and out of the Treasury's balances. These resulted in unpredictable redistributions of reserves, since it was difficult to know the sources of inflows and the destination of outflows. As a result, the usual money market measures were less reliable indicators around the dates of these issues than at other times.

Mr. Mitchell then asked how operations would have differed if the Committee's instructions at the preceding meeting had called for maintenance of the three-month Treasury bill rate at 3.5 per cent. Mr. Stone said that in his judgment it would have been necessary to let free reserves rise to about $300 million, which he thought would have been inconsistent with the instructions the Desk had actually received. But, he noted, there was a second aspect to Mr. Mitchell's question; namely, could the Desk have kept the bill rate at 3.5 per cent by modifying the technical nature of operations within the terms of its actual instructions? For example, could it have bought more bills outright, and relied less on repurchase agreements in supplying reserves? He noted that the Desk had bought about $600 million in bills in the two weeks ending on the Wednesday preceding this meeting--despite which the bill rate rose 6 basis points--and had about $300-$400 million outstanding in repurchase agreements with dealers. It was his estimate that the bill rate might have been lowered by one or two basis points if the Desk had relied largely on outright purchases, and had not made many repurchase agreements. However, he thought that resale of these bills in the current week, when reserve absorption was necessary, could have been expected to raise the bill rate by at least 5 basis points. As it was, a substantial volume of reserves would be absorbed unobtrusively by maturation of the repurchase agreements and by redemption of the bills maturing next Thursday.

Mr. Hickman referred to the Treasury's purchase of bills for official accounts on the Friday preceding the meeting, and asked what their objective was in operating on both sides of the market. Mr. Stone noted that it was routine for the Treasury to buy back newly-issued bonds for trust accounts in varying amounts, to facilitate underwriting of the issue, and described the Friday operation as an extension of this procedure to the bill market. In response to a question from Mr. Swan about the probable volume of corporate and municipal financing in November, Mr. Stone said that it was expected to be lighter than the near-record October volume, but still substantial.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period October 22 through November 8, 1963, were approved, ratified, and confirmed.

Chairman Martin then called for the staff economic and financial reports, supplementing the written reports that had been distributed prior to the meeting, copies of which have been placed in the files of the Committee. Mr. Noyes commented on economic conditions as follows:

> This morning I plan to review very briefly recent economic developments and then turn to a somewhat longer look at trends in the economy that I hope will be helpful to you in evaluating the plethora of forecasts and projections that will be forthcoming in the weeks ahead.
>
> Recent changes in employment, sales, and output can, I think, be fairly characterized as moderately favorable. It now appears that retail sales declined less from their summer highs in September than had originally been estimated, and that they more than recovered to a new high in October.
>
> We are presently estimating that the production index moved up fractionally--perhaps by enough to raise the rounded index a point.
>
> Unemployment declined a tenth of a percentage point--from 5.6 per cent to 5.5--hardly a notable change in itself, but in the right direction. The new orders figures for September were also revised upward, and now show almost a 4-1/2 per cent increase over August.
>
> Total construction activity has been steady, at a high level, up about 5 per cent from a year ago.
>
> The flurry of price increases in the late summer and early fall seems to have subsided in October. There were a few further advances, but also some offsetting declines. While prices will continue to bear close watching, it does not appear that an epidemic of upward price changes is underway, and I would characterize the most recent developments in this area as mildly reassuring.
>
> I will refer again to the McGraw-Hill survey in a moment, but the 4 per cent rise in over-all capital expenditure plans for next year would suggest a moderately optimistic current attitude on the part of the reporting businesses.
>
> This seems to me to add up to a generally favorable situation--not showing for the moment either excessively bullish or bearish tendencies.
>
> Let me turn now to a quick run through on some of the GNP figures that have been and will be very much in the news. As a base, the third quarter of 1963 is now estimated at $588.5 billion. The fourth quarter looks like

$596 or $597 billion--give or take a few billion. This means that the average for 1963 as a whole will be about $584 billion.

Secretary Dillon joined the ranks of the prophets early by releasing two weeks ago projections for the first two quarters of 1964, with and without a tax cut. These suggest that in the second quarter the economy will be stumbling along at a rate of about $609 billion if the cut does not receive early approval, but will zoom to $620 if it does.

In the light of his long uphill struggle to obtain approval of the tax bill, the Secretary may be regarded as a prejudiced witness--but his estimates are not too different from those of many other early birds in the forecasting game. The figures he used appear to be roughly consistent with those produced at a meeting of academic consultants to the Treasury last week and several other models that have been unveiled to the public gaze.

On the present level of around $600 billion, five per cent of GNP is, of course, about $30 billion. This year the increase has been at about that rate or a little better. A five per cent increase would mean an average for the year of $615 billion and a fourth quarter of about $630 billion.

Many guesses now seem to be that the figures will run higher than this with the stimulus of a tax cut--that the average will be in the low 620's--implying a fourth quarter somewhere in the high 630's or low 640's. If the tax cut should be completely rejected, a good many observers doubt that upward momentum would be maintained--and this produces a much wider range--especially for the second half of the year.

It is interesting to note that all the models that include a tax cut and assume that upward momentum will be maintained involve a considerably higher rate of business investment than that suggested by the McGraw-Hill survey. For example, a "balanced" model designed to produce a $620 billion average for 1964 suggests an increase in plant and equipment expenditures more in the neighborhood of 10 per cent than the 4 per cent reported to McGraw-Hill. While inventory accumulation would be somewhat higher than in 1963, a "balanced" model cannot rely too heavily on this as a sustained stimulus. Hence, one must assume that either the impact of the tax cut or a generally favorable economic climate will cause businessmen to revise their expenditure plans upward if we are to achieve the levels of activity that seem to be widely anticipated. The "favorable" projections for 1964 also generally imply a large increase in consumption, with a further rise in auto sales and some advance in residential construction activity. The critical question seems to be whether the tax cut, if it comes, or some other exogenous force will stimulate consumption enough, especially in the hard goods lines, to give rise to a major upward revision in business investment plans.

Mr. Brill made the following statement concerning money and credit developments:

Some commentators have described financial markets currently as confused and nervous, and this describes my own state of mind as well. I'm confused by a money market in which a rebound of free reserves is accompanied by a 10 or 12 point rise in bill rates to the highest levels in over three years. I'm confused by a credit picture which has some of the characteristics of economic boom, against a general economic background of only moderate expansion. I'm both confused and nervous about the squeeze on interest rate differentials, for even with a continuing large volume of long-term saving, there appear increasing indications that the most recent spurt in short-term rates is carrying over into long-term markets as well.

No single factor adequately brings all these disparate developments into focus, but if there is anything approaching a universal explanation, it probably lies in the course of monetary policy and private credit demands since last spring. For some time, we have been congratulating ourselves because the tightening of the credit screws seemed to be having its effects only on short-term rates, without any observable spillover to other financial markets or to nonfinancial markets. Now, however, the cumulative effects of reduction in reserve availability--on bank credit expansion, on bank liquidity positions, and on market expectations--are beginning to show some bite as the economy generates somewhat more than seasonal steam in its credit demands.

Statistically, the effect of the shift in policy last spring is fairly striking. From December to May, total reserves grew at an annual rate of 3 per cent, seasonally adjusted. From May to October, growth in total reserves has been at an annual rate of only six-tenths of 1 per cent, and this all in borrowed reserves. Nonborrowed reserves have declined.

The slowdown in total reserve expansion so far has not limited growth in the private money supply. In fact, private demand deposit expansion has accelerated. This is in large part a reflection of the change in the Government's cash position, however. The Treasury has been pulling down its deposits more than seasonally from the high levels reached earlier in the year, with an exceptionally large drop in October. We have been getting a switch in deposit ownership, but only a relatively small change in the rate of growth in total deposits.

The effect of the tightening shows also in the composition of bank credit. Expansion in total bank credit has been at only a slightly slower pace in the five months since May than it was in the first five months of the year. Expansion in the earlier period, however, was accomplished with practically no net liquidation of Government securities by commercial banks. Since May, banks have had to liquidate almost $4 billion in Governments to meet rising private credit demands. At the end of September--the latest data available--the ratio of bank holdings of short Governments to deposits was down to 7.2 per cent, compared with 7.8 per cent in May and 9.5 per cent at the beginning of the year.

With this background of increasing pressure on the banking system, it is not surprising that a concentration of Treasury short-term financing in late October should put bill rates under strong upward pressure. After switching some $4 billion out of the short-term end of the market in the September refunding, the Treasury rebuilt the supply of short-term instruments through a $1 billion strip on October 22, a $1 billion one-year bill on October 30, and a refunding on October 28 of about $3-1/2 billion of maturing November issues into an 18-month note, some $400 million of which represented new money.

Dealers received substantial amounts of all of these issues, and until the closing days of last week were making only slow headway in reducing their inventories. In part, their difficulties stemmed from bank competition, for bank sales of bills were adding to the market supply at the same time that banks were competing aggressively for corporate funds through CD's. Moreover, seasonal reserve patterns and dealer financing needs were such as to limit the Desk's freedom to moderate market developments through direct purchases for System Account.

Reflecting the various pressures, the bill rate pierced the discount rate and stayed from 5 to 6 basis points over it through the weekly auction.

Pressure is spreading to other maturities, with Treasury bond yields up 4 basis points since the last Committee meeting. It would seem that the cushion between short- and long-term rates has been compressed about as far as possible. Even with this recent rise in bond yields, the spread between long bonds and Treasury bills is down to 57 basis points, compared with 100 at the beginning of the year and in the May-June period. For investors, the gain from extending maturities now is exceptionally small, relative to the prospective capital loss if there should be a readjustment in yield relationships anchored to the present level of bill rates.

The market for State and local government securities is particularly vulnerable. Banks have been supplying about 90 per cent of the funds going into municipals, and if this supply should be curtailed because banks lack other sources to meet rising business loan demands, or because the squeeze on the bill rate-CD spread should cut the flow into time accounts, we could get a substantial reaction in State and local government yields. Municipal markets are in a technically weak position, with dealers' inventories of unsold issues high, the yield spread vis-a-vis long-term Governments exceptionally large, and prospects of a substantial reduction in individual tax rates, particularly in the upper brackets, limiting the enthusiasm of the most important nonbank market for such issues.

In my judgment, the domestic situation as reported by Mr. Noyes does not suggest the need for or even the desirability of a further advance in the costs of financing investment, be it by State and local governments, businesses, or consumers. To avoid it now, however, after market expectations have been conditioned by recent developments, short-term rates probably would have to recede and re-establish a margin below the discount rate. This, in turn, probably would require some slackening of the reins on reserves, so that banks could meet more than just seasonal private credit demands without having to liquidate Governments so heavily. In appraising reserve needs, it is also important to keep in mind that the switch in deposits from Government to private ownership probably has come to an end for this calendar year. In fact, our estimates are for a rise in the Treasury's balance to the end of the year, with a resultant drain on reserves supporting private deposits. Unless the basic economic situation changes substantially in the remaining weeks of the year, a more generous approach to reserve needs than has prevailed recently would appear appropriate.

Mr. Furth commented as follows on the balance of payments:

The payments deficit for the quarter ending in September seems to have been slightly lower than estimated last time; it is now calculated at a seasonally adjusted annual rate of $2 billion, excluding the reflux of window-dressing funds in July as well as all special transactions (prepayment of foreign debts and issue of nonmarketable Treasury bonds to foreign authorities). This rate is less than half of the similarly adjusted average rate for the first two quarters of the year.

The improvement apparently was due in about equal parts to the decline in the outflow of long-term portfolio capital and to a reversal in the movement of money-market funds, including a reflow from the Euro-dollar market. At first glance, it would appear reasonable to attribute the reduction in the outflow of portfolio capital to the interest equalization tax proposal, and the reversal in the flow of money-market funds to the Federal Reserve actions lessening monetary ease. But it should be remembered that the outflow of both portfolio capital and short-term funds, although very much smaller than in the second quarter or even the average of the first half, still was about as large as in the third quarter of 1962. It may therefore turn out that the improvement contained a large seasonal element. Moreover, even if the improvement really was caused by the policy actions mentioned, it may reflect only a transitory initial shock reaction, which would not necessarily carry over to future periods.

Reliable figures for October are not yet available; the tentative weekly data indicate a deficit larger than the monthly average for the third quarter, although probably smaller than the average for the first half of the year.

Developments abroad show a mixed picture. Economic activity in most foreign developed countries still is expanding although the OECD staff expects that growth in Continental Europe will slow down somewhat in the months to come. But Italy, France, and the Netherlands probably will tighten domestic credit conditions, perhaps to an extent that could imperil further growth. If this happened,

U. S. exports to those countries would be reduced while outflows of U. S. capital would be stimulated; the U. S. payments balance would thus be hit simultaneously on two fronts.

Three weeks ago I commented on the cracks in the economic underpinning of those three European countries. Today, Germany may be added to the list. The Stinnes bankruptcy, originally dismissed as an isolated incident, may have been more symptomatic than German reports wanted us to believe. Last week, rumors were prevalent about serious difficulties of an industrial concern of incomparably greater importance than Stinnes, the Krupp family firm. While it has been forcefully denied that any insolvency was impending, it appears that German heavy industry has achieved its record exports, at least in part, at the expense of adequate profit margins; and moreover, that German big business has again engaged in the traditional Central European practice of financing long-term investments by means of short-term bank and acceptance credits. The German press is, somewhat belatedly, taking up the plea for expansion of German capital market facilities, including facilities for public share offerings.

Needless to say, a financial breakdown of German heavy industry would be a serious blow to the economic health of the free world at large, including that of the United States. It seems certain, therefore, that any repetition of the 1929-31 disaster will be averted. But assuming that there will be no such disaster, the present situation could benefit the U. S. payments balance in two ways. First, it could lead to a long overdue reform of European banking and business finance practices and thus reduce European demands for U. S. long-term capital. Second, and more important, it could show U. S. investors that, after all, investments at home, even if they do not promise the spectacular returns that could be reaped abroad during the past 10 or 15 years, may be built on a more solid basis.

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

On the basis of the data available so far, it would appear that the expected October pick-up in domestic business activity did occur, following the August sag and the rather uncertain September showing. The automobile industry is an outstanding element of strength, and recent tendencies have been favorable in such key areas as retail sales, housing construction, plant and equipment spending, and corporate profits. Business sentiment seems to be considerably stronger than a few months ago, with most forecasters seeing a continued expansion through 1964. However, this optimism is based in part on tax cut expectations, which are subject to considerable uncertainties, at least as to timing. Attempts to raise prices in recent weeks have been themselves a reflection of better business sentiment; but, so far, price increases have not been sufficiently widespread to modify the general picture of over-all price stability that has characterized recent years. Stock prices remain close to their peak and do not seem to have been affected materially by the rise in margin requirements.

Recent credit statistics do not suggest any very significant changes. The fact that business loan demand has been a good bit better than seasonal seems consistent with the generally favorable business news. While the growth of total bank credit so far in 1963 has run somewhat behind the comparable period of 1962, for many weeks now we have seen required bank reserves running $100 to $200 million ahead of the Board staff guideline, with the excess last week even higher. Nonbank liquidity has kept up last year's substantial rate of gain and is surprisingly high in relation to gross national product for this stage of a cyclical expansion.

We can find a good many grounds for encouragement in the sharply better third quarter balance of payments results, particularly with respect to private capital exports, both long-term and short-term. The former have of course been cut drastically by the interest equalization tax proposal. As for the short-term flow, there is a wide variety of items and perhaps a wide variety of causes for the improvement; but the improvement was so great and so general that it suggests the possibility of an appreciable contribution from the lesser degree of ease in monetary policy. Preliminary October figures, however, indicate that the deficit is still far from solved. I hope we can avoid this time the widespread tendency in this country to become overoptimistic when the balance of payments registers one good quarterly gain.

With the Treasury's November refunding virtually completed and with no more important Treasury financing in sight for most of the remainder of the year, we would seem to be comparatively free to determine monetary policy without particular reference to Treasury financing schedules.

Turning to policy, I believe a good case can be made for seeking a slightly slower rate of bank credit expansion over the coming months than has prevailed in the last year or so--always, of course, with due allowance for seasonal factors. I am led to this conclusion by recognition of the need for continued vigilance with respect to the balance of payments, the current signs of greater strength in the domestic economy, and the fact that recent rates of growth in bank credit, nonbank liquidity and required reserves would seem to leave room for some slight move toward lesser ease without appreciable risks. The degree of change I am thinking of is quite moderate and might be symbolized by a reduction in free reserves to a level averaging around zero. Short-term rates are likely to take care of themselves pretty well in the next few weeks, in the light of seasonal pressures, sizable dealer holdings, and general expectations that business will continue to move ahead fairly vigorously. While a 90-day bill rate a little above the discount rate may give rise to some gossip about a change in the latter, I don't consider this a serious problem.

For the moment a rise in the discount rate would appear decidedly premature. A wait-and-see attitude is clearly appropriate. Looking a little further ahead, however, I am troubled by the implications for us of the strongly anti-inflationary credit policies that are becoming increasingly prevalent on the European Continent. These could ultimately build up considerable pressure for defensive measures on our part. Until recently the possible adverse effects of rising U. S. interest rates on the U. K. have been something of an inhibiting factor in our own considerations. Lately, however, there has been growing evidence of concern in the U. K. over the danger of an "over-heated" internal business situation. All of this suggests that a higher U. S. discount rate might have to receive serious consideration within the next few months.

The directive should, I believe, be modified slightly if the Committee decides, as I hope it will, that we should seek a slightly slower rate of growth in bank reserves and bank credit.

> Finally, I should like to refer again in passing to the fact that prevailing time deposit rates are very close to bumping against the ceilings set by Regulation Q, so that action in the near future to liberalize those ceilings would appear distinctly timely. The Board's recent action in raising margin requirements was well timed and well received. Perhaps a similar opportunity now presents itself with respect to Regulation Q.

Mr. Hayes added that he was skeptical that Europeans would actually avoid the use of monetary policy instruments to restrain inflation.

Mr. Shuford said the latest data available indicated that economic activity in the Eighth District had continued to improve, but, as in the rest of the nation, the rate of expansion had moderated somewhat since mid-year. Industrial use of electric power in the major cities of the District, which increased markedly from January to July, had risen at a much lower rate since July. Total employment had remained unchanged since June, compared with a four per cent annual rate of expansion during the January to June period. On the other hand, the volume of bank debits had continued to expand rapidly in the District. Total bank credit had risen more sharply since June than in the rest of the nation. Total loans, especially to businesses, had increased substantially, and bank deposits had also risen since mid-year.

Nationally, Mr. Shuford said, broad measures of economic activity indicated some slowing down since July in the pace of expansion. Industrial production, construction, and employment had all been about the same since mid-year, and although personal income had continued to move up, the rate of increase was lower.

With respect to monetary experience, Mr. Shuford said that recent developments seemed to him to have been reasonably satisfactory, considering the continued business improvement and the Treasury's financing activities. Strengthened interest rates and continued monetary expansion had been compatible. The recent level of interest rates probably had been as high as was warranted by the international balance of payments situation. On the other hand, the increase in bank reserves, bank credit, and money since mid-year did not appear to have been unreasonable. Expansion in recent weeks had been unusually large, but the same thing had happened at this season in each of the last several years, and might reflect a new seasonal pattern.

As to policy, Mr. Shuford said he would favor no change; a continuation of recent developments was in order. A three-month Treasury bill rate of about 3.50 per cent seemed satisfactory to him, and increases in reserves, credit, and money at about the rates that had prevailed since July seemed appropriate for the near future. He recognized the continuing need for alertness with respect to price increases and other evidences of excessive demand, although he saw no such evidences as yet.

Mr. Shuford said that he would not recommend a change in the discount rate at this time. He felt that the policy directive was satisfactory, except for the reference to Treasury financing.

Mr. Bopp reported that information that had become available since the last meeting pointed to some deteriorating in Third District business conditions. However, the evidence was mixed. Unemployment data were mildly encouraging in contrast to weakness shown by production and demand indicators. The weakness in demand probably reflected in part the fine weather, which may have depressed department store sales.

There was increasing pressure on reserve positions of District banks during the past three weeks, Mr. Bopp said. Both the basic reserve deficit of reserve city banks and borrowing at the discount window by country banks rose substantially during the first two weeks and then declined somewhat in the past week. At reporting banks, loans and investments and total deposits declined.

In view of recent business and financial developments, a continuation of present policy seemed appropriate, Mr. Bopp said. Business expansion continued at a moderate pace, despite the recent trend toward a more optimistic appraisal of business prospects. The index of wholesale prices remained stable, and there were still enough unused resources to meet prospective increases in demand for the foreseeable future. With unused resources and only a modest rate of expansion in capital expenditures, a further rise in market rates would be cause for concern. In his judgment the recent improvement in the balance of payments relieved some of the pressure for firmer rates.

The analysis that Mr. Hayes had given, Mr. Bopp continued, was one that had disturbed him since the beginning of the Committee's trend toward tighter monetary conditions. If European countries moved interest rates up and we felt forced to respond out of balance of payments considerations, a serious problem could be posed for our domestic economy, which in turn could affect the entire world.

Mr. Bopp concluded by saying that conditions called for no essential change in policy for the next three weeks. Reserves should be supplied to meet seasonal needs and to prevent member bank borrowing from rising much above the recent level. He felt that the present directive was appropriate with the deletion of the reference to the Treasury financing, and would recommend no change in the discount rate.

Mr. Hickman said that, as Messrs. Noyes and Hayes had reported this morning, the pace of business activity was clearly quickening, and he had nothing significant to add to the story. He would, instead, like to report to the Committee the highlights of a meeting of 23 Fourth District economists held recently at the Federal Reserve Bank of Cleveland.

These economists, Mr. Hickman noted, were from major industrial concerns in steel, autos, machinery, rubber, oil, etc., with headquarters or substantial operations in the Cleveland District. All of the business economists, who had usually been on the very conservative side, now emphasized the current strength of the economy, although they differed as to the durability of that strength. In view of the conservatism of the group, he was impressed by the fact that three-fifths of them forecasted continued expansion through next year, without any specific assumptions as to a tax cut.

For the first time in several years, the Fourth District economists included within the horizon of their outlook the possibility that expansion could become excessive, and hence unsustainable, in the near-future, Mr. Hickman reported. It was noteworthy that reference was made to the possibility that the economy might "blow out at the top side," although no consensus was reached. Much had been said about the change towards firmness in the industrial price picture, and more price increases were believed to be ahead.

It was generally felt that the steel industry this year would show a total output of 108 million ingot tons or more, and a clear all-time record for steel consumption. An ingot output from 105 million to 111 million tons was forecast for next year. For autos, it was believed that output at a rate of 7-1/4 million cars or better could be maintained during the first half of next year, with the rate dropping below 7 million in the second half. For the entire year 1964, the most frequent forecasts were 6.8 or 6.9 million cars domestically produced, although the spectrum of estimates ranged from a low of 6.5 million to a high of 7.5 million.

Insofar as other industries were concerned, Mr. Hickman said, heavy machinery lines reported a marked shift in recent months from dull to brisk orders. Numerous industries represented at the meeting indicated substantial gains in volume this year and further, although more moderate, gains next year; these included aluminum, rubber, chemicals, oil and food products. In the construction area, there appeared to be a general feeling that fears about overbuilding of apartments were not well founded; the argument was that although overbuilding had occurred in one or two large cities, the apartment boom was spreading through medium-size and smaller cities of the country. Overbuilding of shopping centers, however, was a reality and retrenchment was the order of the day. Representatives of the railroads were not happy about the present arrangements for arbitration of the workrules dispute; they expected another strike threat in the late winter or early spring.

Mr. Hickman said that the present state of economic activity and business sentiment, and the potential upward movement of the price level, all lend support to a view that the System drift towards slightly less ease had been appropriate. The same inference could be drawn from international interest-rate relationships, which now appeared to be in some sort of rough, although perhaps temporary, equilibrium. Until the price question was resolved he would favor a continuation of the present degree of firmness in the central money market. With a more even distribution of reserves than in the past week or two, this would probably mean free reserves hovering around the zero level, Federal funds holding steady at 3-1/2 per cent, and a bill rate fluctuating narrowly around the discount rate.

Well-informed bankers in the Fourth District had recently expressed concern over the possibility that higher rates on certificates of deposit might attract funds out of local banks into money market centers. Mr. Hickman felt this situation might be averted by appropriate changes in Regulation Q, as Mr. Hayes had suggested at this meeting and the last.

Mr. Mitchell said that it seemed to him that the Committee had slipped into a rather unproductive attitude toward the problem of appropriate monetary policy. For some time the alternatives had been formulated as no change in policy or slightly greater firmness, and his side had been losing right along. While this had been going on, the possibility of fiscal action had been receding. The tax bill obviously was not going to be passed this year, and there was increasing question about next year. Even if the tax bill passed, there was a good chance that Government expenditures would be held down to the point of nullifying the effect of tax reduction.

According to the surveys, Mr. Mitchell said, no capital boom was in prospect. The McGraw-Hill survey, which indicated a four per cent increase in capital spending from 1963 to 1964, implied no increase over the level in the fourth quarter of 1963. In his opinion a further rise in capital spending was necessary at this stage of the cycle, and a higher level of new car sales than the forecasts Mr. Hickman had mentioned would be required if the consumer side was to provide a stimulus.

It was Mr. Mitchell's opinion that the Committee should seriously consider some easing. He thought it should be more accommodating of credit needs in the next 3 to 6 weeks; otherwise it would be flirting with the danger of a sharp rise in both long- and short-term rates, which would serve no purpose. It might be well to let the bill rate drop a few basis points, partly to scotch rumors of an imminent discount rate increase. He did not urge any change in the directive, but favored a somewhat higher level of free reserves and a reduction in member bank borrowing to the neighborhood of $200-$300 million.

Mr. Shepardson said that the aspect of the economy he found encouraging was the fact that a boom was not underway. He would be most concerned if there was a big surge in business activity; the groundwork was already laid for expansion in wage rates, costs, and prices, and some degree of continuing restraint was needed. In his judgment the policy the Committee had been following in recent weeks remained appropriate. He would not want to see any relaxation, although he recognized that there would be a seasonal need for reserves in the next few weeks and felt that these reserves should be supplied. He thought the recent rate of reserve expansion was a little more precipitous than desirable, and should be cut back. Along with Mr. Hickman and Mr. Hayes, he favored a somewhat lower level of free reserves than during the last three weeks. He saw no need for a change in the directive except for deleting the Treasury financing reference.

Mr. Robertson commented as follows:

> Business continues to expand, but seemingly without the kind of vigor that would assure a strong or ebullient surge carrying over into 1964. There is encouragingly little of this expansion reflected as yet in the over-all price indexes, although these will bear watching. But there is discouragingly little reflection of the business rise yet in the unemployment figures, and this argues strongly against any premature tightening of monetary policy.
>
> Our balance of payments position has clearly become better, even if for reasons that are not fully explained. Meanwhile, on the financial side, we face some emerging problems--partly of our own making.
>
> Bank loan expansion has been substantial, as has also been money supply and time deposit growth. But in the tighter reserve situation that has prevailed since midyear, banks have been led to sell Governments and cut down on purchases of municipals. If this bank reaction continues or increases, it will not only slow down the growth of private liquidity but also very likely apply some further unsettling upward pressure on the capital markets generally. I would not want to aggravate such movements at this time.
>
> The bill rate is also a thorny problem right now. By our own operations and increased Treasury auctions of new bills we have managed to push it so articifially high that it is now embarrassing us. (As a matter of fact, at the close Friday, November 8, 67 per cent of all bills outstanding were yielding more than the discount rate.) With the peak of seasonal pressures still ahead, we could have even higher bill rates on our hands between now and December 20. The potential consequences, as the comments this morning indicate, are uncomfortable to contemplate. They include the almost certain spread of rumors of a further discount rate hike, with perhaps enough market reaction to force the System's hand; pricing enough smaller banks out of the CD market to also demand another

increase in the Regulation Q ceilings; a spreading wave of sympathetic rate adjustment through the longer term markets; and, just possibly, some corresponding upward adjustment in foreign official or market interest rates that would provide an argument against letting our rates slide back down from whatever year-end seasonal peak they attained.

The Treasury was quicker than we were to foresee some of these adverse consequences and to act to try to forestall them. But how did it do so? By jumping into the market and buying bills purely and simply with a rate objective in mind. Whatever else last Friday's operation accomplished, it demonstrated official pegging intentions for all to see. To be sure, one could argue that this peg is more sophisticated than the old one; we do not maintain a fixed rate, but a range, with an upper and lower resistance point; and the Committee had been wise enough to move that range occasionally. But the same old lesson still applies: you cannot pursue a rate target without giving up control of the volume of reserves and, ultimately, of bank credit and money.

It seems to me the basic question today is: how can we extricate ourselves? For many months I have been a minority advocate of not being so concerned with bill rate levels, but of concentrating rather on maintaining a stimulative reserve posture. But having assiduously devoted both Federal Reserve and Treasury efforts to raising the three-month bill rate artificially high in the cluster of rates, we cannot now just turn our back on further bill rate changes, focus on reserves only, and pretend no concern or responsibility for ensuing rate developments.

Given the likely immediate consequences of such a course, I think we have no real alternative but to conduct our operations during the next few weeks of peak seasonal pressure in such a way as to minimize any excess of the three-month bill rate over the discount rate. This I hope we could accomplish by maintaining somewhat greater reserve availability, producing less bank borrowing and Federal funds rates occasionally below 3-1/2 per cent. This should be achieved by Desk efforts to purchase bills whenever appropriate to this end, rather than either deliberately undertaking bill purchases just to drive rates down from now on. Hopefully, when seasonal pressures are reversed late in December, we should be able to concentrate progressively more on the performance of the economy and its needs for funds and progressively less on the bill rate alone. In the meantime, I hope steps are taken with the view of prevailing upon the Treasury to undertake any further bill rate "rigging" it has in mind by use of the more arms-length procedure of changing the size of bill auctions, rather than repeating the injection of itself into the market, as its biggest buyer, as happened last Friday.

I believe the policy I have outlined could be construed as still falling within the bounds of the current directive. On the other hand, if a change in the directive is regarded as desirable by the Committee, I would think the most consistent alternative would be to adopt something like a mirror image of the directive adopted last January 8. Thus, the second paragraph could say:

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

Mr. Mills commented that Mr. Brill's statement offered factual evidence of the need for revision in the direction of System monetary and credit policy. Accordingly, his remarks would focus on some recent developments that were confirmed indirectly in Mr. Young's report to the Committee, that argued for a change in policy that should be possible of accomplishment without damage to the present financial defenses set up to combat our adverse balance of payments difficulties. He found himself in substantial agreement with what Mr. Mitchell and Mr. Robertson had said. He was inclined to believe that when Federal Reserve System history was written it would record that this period provided a classic example of the lag in time before System policy takes hold, in this case a policy that threatened economic and financial harm. If such was the case, it was incumbent on the Committee to change policy with the knowledge that the beneficial effects of the change would not yield their impact for some time into the future.

Mr. Mills then made the following statement:

> Surcease from the Federal Reserve System's enforced watch and ward kept over this nation's difficult balance of payments situation seems to be an early prospect. That indications to that end emanate from press reports of statements made by important United States officials outside of the Federal Reserve System does not lessen their authoritativeness. It is surprising, however, that these policy statements on matters intimately related to the System's responsibilities are reported in the public press as intimating policy decisions already made in the light of understandings reached by United States and foreign financial officials. Even though the background to these statements, and implementation of the monetary and credit policy that they portend, have not been discussed by the recognized policy-making body in the field of monetary authority--namely, this Committee--the purport of these statements should be taken at face value as an opportunity to revise our policies along enlightened lines that will give proper place to domestic economic considerations.
>
> The Secretary of the Treasury is reported to have said that higher interest rates are unnecessary for balance of payments reasons. The November ninth edition of the New York Times carries a Paris report that the Chairman of the Council of Economic Advisers has stated that the principal European countries have agreed not to raise their interest rates in order to counteract higher interest rates in the United States. The November eleventh edition of the New York Times, in a despatch from Brussels, also reports that an understanding has been reached that European financial authorities will not raise interest rates in their countries as an offset to higher interest rates in the United States.
>
> These various statements and reports seemingly give belated recognition on the part of some United States officials that the monetary and credit policy forced on the Federal Reserve System for balance of payments reasons has begun to produce what were inevitably undesirable

domestic economic reactions and should therefore be relaxed. By the same token, it is implicit from the financial climate that was allowed to develop that the domestic viability of the country should not be sacrificed to a needlessly restrictive Federal Reserve System monetary and credit policy and that henceforth any measures required to combat further balance of payments difficulties should be taken in the area of fiscal controls.

In my opinion, a start should now be made toward increasing the supply of reserves available to the commercial banking system so as to relieve some of the existing upward pressure on interest rates and to reduce a very real threat to appropriate growth in the money supply.

Mr. Mills added that he would favor adoption of the directive revision suggested by Mr. Robertson.

Mr. Wayne said that the generally favorable character of Fifth District business had changed little in recent weeks. Rates of insured unemployment continued to decline seasonally and remained well below the national average. On the other hand, retail sales showed less than seasonal strength, and dollar sales of flue-cured tobacco were 11 per cent lower than a year ago. Man-hours in nondurables were off in September despite good gains in all sectors of the textile industry. Current developments in textiles included wage increases varying somewhat as to extent and timing but likely to be industry-wide by the end of this month, a continuing slow trend toward higher prices, and renewed consideration of a one-price cotton bill. Textile respondents in the Reserve Bank's latest survey reported rather general increases in new orders and shipments but were pessimistic about profits. Manufacturers of other nondurables, however, presented a generally neutral picture, while producers of durables indicated further increases in both new orders and backlogs. In general, the survey showed business optimism continuing, although less pronounced than three and six weeks ago.

On the national scene, Mr. Wayne said, it now seemed clear that business activity was at a high level in October. Record highs in the production and sale of automobiles plus a near-record level of new construction were major contributions toward a very good month. These were supplemented by small increases in steel production and by a continuing high level of employment. The strong recovery in retail sales indicated in the latest Department of Commerce estimates was especially encouraging to him. While these estimates were subject to revision, they provided fairly concrete evidence of growing strength in an area which had thus far been about the weakest in the present upsurge.

Despite the October improvement, Mr Wayne continued, most major components of business activity had shown quite modest rates of increase over the past three or four months taken as a whole, with a few remaining about steady or declining slightly. In general, the level of activity had been high but there had been very few signs of a strong movement toward higher ground.

As to policy, Mr. Wayne said he did not share the concern of those who feared that the supply of reserves was inadequate. There had been no adverse developments from the international side in the past three weeks and perhaps some small improvement. Domestically, the increase in margin requirements should help to correct any tendency toward excesses which might exist in the financial area. The increase injected an element of uncertainty into the market which, together with other market forces, helped to push bill yields last week to their highest levels in more than three years, with most of them going significantly above the discount rate. Any further substantial rise in short-term rates at this time would logically be interpreted as evidence of a move toward a further restriction of credit, probably including an increase in the discount rate. Mr. Wayne did not believe that conditions at this stage required or justified an increase in the discount rate. He therefore favored continuation of the Committee's present policy, with the aim of keeping short-term rates within about the same range as had prevailed for the past three weeks. He would renew the current directive with the elimination of the reference to Treasury financing.

Mr. Clay said that in his judgment the most significant piece of current information about the state of the domestic economy was the McGraw-Hill report on business capital outlay plans. Little satisfaction could be gained from the projected increase for 1964 when note was taken of its limited size and the fact that it indicated an annual rate of business capital outlays somewhat below that of the current quarter. Mr. Clay said that this evaluation was applicable even if allowance was made for possible understatement, since the upward revision would need to be substantial if business capital outlays were to provide the needed thrust to economic activity.

Mr. Clay thought that continued expansion in total economic activity in the months ahead rested upon advancing levels of demand and output and upon the resulting stimulus from these demands to capital investment. An acceleration in capital investment was particularly important at this advanced juncture of the business upswing, he felt. In view of the McGraw-Hill results, it was quite apparent that there was need for continued stimulus to over-all demand and encouragement to capital investment. If the cyclically-sensitive sectors of demand and output simply held at the advanced levels of recent months, prospects for over-all expansion in the period ahead were seriously clouded.

In view of the moderate pace of economic expansion in recent weeks, the continued problem of resource utilization, and the current projection of business capital outlays, the case for avoiding any reduction in credit availability still stood, in Mr. Clay's opinion. He thought that member bank reserves should continue to be supplied so as to provide for bank credit expansion and to avoid putting upward pressure on interest rates through monetary policy actions.

Mr. Clay felt that the basic policy for the period ahead should be the same as that determined at the preceding meeting of the Committee.

Since that meeting, interest rates had moved upward without any monetary policy intention of the Committee to produce that result. If continued reserve availability for credit expansion in the period ahead resulted in a lower Treasury bill rate, Mr. Clay said, that development would be in keeping with this policy.

Mr. Scanlon reported continuing evidence of gradual improvement of economic activity in the Seventh District. The Reserve Bank's current survey of economists of major business firms and financial institutions in the District revealed widespread optimism concerning economic prospects not only for the remainder of the year but for 1964 as well. Of the first 14 to respond only two expected a decline in general business activity to begin before the middle of next year, assuming no tax cut. With a tax cut, all 14 expected any general decline in business to be postponed at least until the second half of 1964 and only 4 expected business to decline before the end of next year.

A number of the respondents reported price increases for the items purchased by their firms, but these increases thus far had been confined to a limited range of products. Inventories and employment were expected to rise somewhat in those firms during the next six months.

A number of respondents indicated that their views on the prospects for the economy and for their own firm had become more favorable during the past six months while none indicated that his views had become less optimistic.

Data on capital goods orders for September, Mr. Scanlon said, confirmed the improvement reported by large District firms during the past two months. The view that capital goods spending would be an expansionary factor in 1964 was becoming increasingly widespread. Meanwhile, it had become common to anticipate a decline in auto sales of about one-half million units from the 7.6 to 7.7 million now estimated for 1963. Auto sales, of course, continued excellent, and record production was scheduled for the remainder of the year.

Employment had increased somewhat further during the autumn in the Seventh District and unemployment had continued to decline. In September, all District States estimated their unemployment rates to be well below the national average. Even Michigan estimated a rate of only 3.9 per cent compared with 4.8 per cent for the nation.

Mr. Scanlon commented that reports of Seventh District banks showed a relatively large contraction in credit during October, relatively greater than in the nation, reversing the very sharp expansion in September. The recent decline reflected repayments by securities dealers and finance companies, but was due mainly to liquidation of Government securities, especially of longer maturities. Also, in the past two weeks holdings of municipals were down slightly. Business loans leveled off in the second half of October and gains for that month were not very broadly based, with a considerable part of the rise possibly related to commodity dealers' anticipations of higher prices. A large rise, mostly in one bank, was reported in the most recent week.

The large Chicago banks had been experiencing increased reserve pressures, Mr. Scanlon said, and had borrowed at the discount window, issued additional certificates of deposit, and sold Government securities. Like Mr. Brill, Mr. Scanlon was confused by some of the apparent conflicts in the bank credit picture.

As to policy, Mr. Scanlon said he would favor maintaining the current posture. With the short-term bill rate near the discount rate and banks tending to reduce holdings of long-term investments, he would be hesitant to exert additional pressure that would result in a further increase in bank borrowing at the discount window. He would maintain current policy and observe developments for the next three weeks. The Committee might find at that time that it had little choice but to accept further tightening. Reference to the Treasury financing should be deleted from the directive, Mr. Scanlon said, and he would not favor change in the discount rate now.

Mr. Deming reported that "moderate expansion" continued to describe current economic trends in the Ninth District. The District personal income estimate for September was slightly higher than in August and up four per cent from a year earlier. Department store sales were picking up after an unseasonably warm early October. New car sales and sales of farm machinery had been particularly good this fall and a big surge in the bank debit figures in both September and October also suggested high level spending at retail. Construction activity, on the whole, had been quite strong. Employment statistics for October showed only moderate improvement but unemployment rates continued below year-ago levels.

Mr. Deming commented that the most significant recent development affecting prospects for the Ninth District economy was the Russian wheat purchase program. Very little, if any, of the District's spring wheat might be involved in this deal; however actual and prospective exports of wheat, mostly from the hard winter wheat areas, had had a sharp impact on all wheat prices. If 150 million bushels, or more, of U. S. wheat actually were exported to Russia over the next several months and wheat carryover was substantially reduced, wheat prices were likely to continue firm against the practical ceiling set by the Commodity Credit Corporation in their formula for releasing wheat stocks for purchase. Without this expanded demand and with lower support prices in prospect for 1964 production, Mr. Deming said, wheat prices might have been expected to decline to minimum support levels. In short, the Russian deal could make a multi-million dollar difference in farm income figures for the Ninth District over the balance of this crop year and into the new crop year. Wheat was especially important to the Ninth District since it brought in more than 10 per cent of District cash farm income and about 40 per cent of farm income in North Dakota.

Bank credit in the District, Mr. Deming said, was currently expanding about in line with seasonal expectations, and deposits were showing a larger than seasonal improvement. At the weekly reporting banks, total bank investments declined seasonally during October with loans holding about even. Both loans and investments advanced at more than normal seasonal rates at the country reporting banks.

Some reserve pressure had been evident at the Ninth District's larger banks during most of October, but more recently the situation had eased. As of the Friday preceding this meeting, only four banks were borrowing at the Minneapolis Reserve Bank, and six were borrowing at Helena. District banks continued as net purchasers of Federal funds but total purchases declined somewhat in late October and early November.

With respect to policy, Mr. Deming said he would favor essentially no change. He would pretty well discard the bill rate as a policy guide and focus instead on reserves and reserve availability. He was a little disturbed by the recent run-up in the bill rate, particularly after hearing Mr. Young's report. For the next three weeks, sufficient reserves should be provided to meet normal seasonal expansion in bank credit, but no more. He would not try to recapture the reserves already added to meet what seemed to have been a larger than normal seasonal deposit growth. In other words, he would start from the present base of actual required reserves and supply reserves pretty much in keeping with the needs outlined in the Board staff's reserve projections. This would mean that the Desk would inject approximately $200 million of reserves over the next three weeks. From then until the end of the year, there should be just about an even balance so far as reserve "put and take" was concerned. If there was more than a seasonal demand for credit over the balance of the year, this would be reflected in a somewhat lower level of free reserves. He would not take any positive action to try to push the level of free reserves down or the bill rate up, but instead would let market forces reflect themselves. He recognized the difficulty of such an assignment for the Desk and the element of judgment that was involved. But under this policy there might be little appreciable impact on rates during the period until the end of the year.

Mr. Deming said he was not sure that a change in the directive was necessary, but if one were to be made he would revise the second paragraph to call for operations "with a view to meeting seasonal needs for bank reserves."

Mr. Swan reported that the limited amount of information for the Twelfth District that had become available since the preceding meeting indicated no marked changes. Business activity seemed to be continuing to rise moderately and business sentiment was optimistic, although there seemed to be some concern about the timing and ultimate fate of the tax bill. For the three weeks ending October 30, District weekly reporting banks experienced a somewhat smaller increase in total loans and investments than did reporting banks in the nation as a whole. The loan increase was about the same as nationally, but the decrease in Government security holdings was somewhat greater. The larger banks in the District were still net sellers of Federal funds.

As to policy, Mr. Swan said it seemed to him that the background was still one of moderate business expansion, with little indication of any real upsurge. On the other hand, the balance of payments position was improved. He was impressed by several things. First, some of the recent growth in private deposits had resulted from a substantial drop in Treasury balances, and the decline in the latter presumably was over for the rest of the year. Secondly, in addition to the effects of improved business conditions, the money and capital markets had been influenced by somewhat special circumstances--a substantial volume of Treasury bill issues and a very heavy volume of corporate and municipal issues. Finally, general uncertainty with regard to the course of monetary policy had been engendered by the rise in the bill rate. It seemed to Mr. Swan that, insofar as possible, the Committee ought to provide a breathing spell, and try to assess the strength of market forces. The Committee could continue its present policy for the next few weeks--by which he would mean offsetting any upward rate pressures from seasonal forces--and see what happened. If as a result there should be a decline in the bill rate, Mr. Swan would make no attempt to offset it. It would seem that under this policy member bank borrowing could be kept somewhat below $400 million. He would resolve doubts on the side of ease rather than, as he thought had been done in recent weeks, on the other side. He would not change the directive except to delete the reference to Treasury financing, although he had some sympathy for Mr. Robertson's suggestion.

Mr. Irons reported that conditions in the Eleventh District were generally favorable, although mixed. The drought was affecting wide parts of the District, especially the coastal areas. This was acting adversely on some kinds of agriculture, particularly the conditions of the ranges.

The industrial production index for the District had set a new record high, Mr. Irons said, rising several points in the past few months. Nonagricultural employment had moved up one per cent and had been rather firm over the District. Construction contract awards in the latest month were down somewhat but for the first nine months of this year were nine per cent above the equivalent period last year. Crude oil production in the District showed no change, and retail trade had been quite high relative to a year ago. Trade in October was lower than in September, but seemed to be picking up in the most recent week or two.

At District commercial banks, Mr. Irons continued, total loans and investments had declined recently. This was due mainly to a decline in holdings of Treasury bills; the loan decline had been slight. Banks were not borrowing at the discount window in very large amounts, although borrowings were somewhat higher than they had been for the past three weeks. Purchases of Federal funds by District banks had been high. As had been the case for several months, these purchases were concentrated largely at two banks, although two or three other banks had bought funds in sizable amounts.

Mr. Irons said he would leave the directive unchanged and continue policy as it has been carried out during the past three weeks. He would favor neither additional firming nor greater ease at this time. He was somewhat disturbed by the run-up in the Treasury bill rate to 3.56 per cent because of resulting rumors in the press and in the market. He hoped the Committee could avoid a repetition of the June-July situation, when it was faced with widespread anticipation of discount rate action because the bill rate was so far above the discount rate; he did not think the discount rate should be changed at this time. He thought the Committee should concentrate its attention on reserve availability, meeting seasonal requirements and holding at that level. He did not know whether or not the bill rate could be ignored; if it rose, the Committee might have to react. It was his hope that with some of the recent pressures removed the bill rate would tend to fluctuate around the 3.50 discount rate.

Mr. Ellis noted that a Western Massachusetts mutual savings bank was now advertising the highest rate on savings deposits of any of the nation--five per cent on one-year deposits. Mortgage money in the area was available at 5-1/2 per cent, and he thought the bank would find it difficult to operate with that margin. Other savings banks were showing no disposition to follow suit. One New Hampshire commercial bank reported it was having difficulty meeting competition on time certificates of deposit as rates moved up, and was urging relief from the present Regulation Q limits. Other banks were concerned about the same problem.

Mr. Ellis said that there had been no significant changes in the general economic situation of the First District recently. On the basis of year-to-year comparisons, financial data showed strength, production was about unchanged, and the employment situation showed weakness.

The Boston Reserve Bank had just held a semi-annual meeting of District economists, Mr. Ellis said, and found them optimistic. The median of their estimates for GNP in the second quarter of 1964 was $610 billion. Particularly notable was the fact that the range between the highest and lowest projections was the smallest in the 12 years since these conferences were started. Question was raised as to whether a tax bill could be passed if business continued good in the early part of next year.

Turning to monetary policy, Mr. Ellis noted that for some time the Committee had wanted to improve balance of payments conditions by affecting short-term outflows, and the staff reports at this meeting showed that some improvement had been accomplished. One might argue that in light of the improvement the Committee should rest on its oars. But Mr. Ellis recalled the argument that the Committee was not using monetary policy sufficiently for balance of payments objectives. For his part, he had no conviction that any permanent improvement had been achieved. He also lacked confidence that the Europeans would renounce monetary policy in dealing with their current problems.

Domestically, Mr. Ellis noted, business loan expansion in September and October had been greater than seasonal. The money supply, seasonally adjusted, was rising sharply, and despite the Committee's July shift to a policy of less ease, required reserves against private deposits were expanding well above the 3 per cent guideline. This growth was real, even if it reflected a shift from reserves held against Treasury deposits. Mr. Ellis said he felt nervous about the degree of liquidity that had been built up under the policy the Committee had followed this year. He also noted that even with free reserves exceeding $100 million in the last few weeks, Treasury financing activities combined with market influences had moved short-term rates up.

Mr. Ellis said he could agree with those who advocated meeting seasonal needs for reserves and letting market factors work. It was his guess that this would mean some further rise in bill rates. The alternative would be to hold short rates down by supplying additional reserves. He would prefer to concentrate on reserve availability--meeting seasonal needs, but anticipating that actual credit demands would exceed their normal seasonal levels. As targets he would suggest free reserves in the range $0-50 million, and bill rates fluctuating near present levels, above the discount rate. Mr. Ellis concluded by saying he did not favor a change in the discount rate at this time.

Mr. Balderston said that like Mr. Brill and others he was confused by recent developments. He felt that he understood what was happening to the bill rate; it had been increased by recent Treasury financing operations. He noted that, normally, at this time of the year the Committee felt it must take care of seasonal needs, and he had started with the assumption that this year seasonal needs could be accommodated without too much attention to bill rate fluctuations. At the next stage in his reasoning he concluded that enough reserves should be supplied to meet seasonal needs. He then began to consider what lay ahead of the Committee next year, both internationally and domestically. In the international area, he believed that European nations would protect themselves against uncontrolled inflation, regardless of recent assurances that they would avoid the use of monetary policy; no promises of this type would stand up in countries with memories of hyper-inflation. Domestically, there were three factors he thought relevant to the outlook. First, he had been told that the Presidential appointees would not succeed in solving the problem of railroad featherbedding. Secondly, he noted that Hoffa was already announcing his plans for the year ahead. Third, the automobile industry had wage negotiations scheduled for August 1964.

Mr. Balderston said he had looked back to some remarks he had made to the Committee six months ago to see if he could find any guides for himself. He then presented the following statement:

> Six months ago I spoke of my concern about two questions:
> (1) that an appropriate economic policy for the nation called for "holding the line" on costs and prices;
> (2) that monetary policy should contribute to liquidity adequate for the economy's transactions but not so great as to lead to:
> (a) leakage of funds to other countries;
> (b) speculative excesses;
> (c) imprudent decision-making by borrowers and lenders.
>
> It is still my belief that a "hold-the-line" policy on costs and prices is of fundamental importance, both in achieving equilibrium in our balance of payments, and in creating job opportunities at home.
>
> As to the second policy question, how much liquidity is appropriate right now, I suggested certain benchmarks to distinguish between enough to nourish the economy and too much. I indicated that, as of last May, I would favor a policy of somewhat less ease and a probing action to discover its impact. As an aid to this determination, I then suggested that this Committee watch the following indicators:
> (1) The relation of short-term rates here and abroad.
> (2) The <u>total</u> required reserves supporting <u>private</u> deposits. Last May I favored an increase in such reserves at a rate less than 3 per cent annually, but with a lower limit that would still permit some further expansion in private <u>demand</u> deposits.
> (3) The expansion of bank earning assets in relation to legitimate loan demand. In short, I favored a rate of increase of bank acquisitions of savings plus the creation of bank credit to permit money-supply growth in keeping with the transactions needs of the economy without inducing the granting of unsound credit.

As to the first of my tests, the bill rate and Federal funds rate are both at about the discount rate and, in addition, approximate the covered short-term rates of England and Canada. The outflow of short-term capital has diminished, temporarily at least. A further rise to a point that would induce an inflow of short-term funds to this country might force England and Canada to raise their own rates. Moreover, if our bill rate rises too near the going rate on negotiable CDs, the exodus of large amounts of time deposits from the commercial banks would lessen their willingness to absorb municipal bonds.

The second of my tests has to do with the growth in reserves. In May, I suggested cutting back the rate at which those behind total private deposits had been growing, namely 3.2 per cent. In fact this rate has increased even faster at an annual rate of over 4.5 per cent. This has permitted required reserves behind demand deposits to grow at an annual rate of close to 3 per cent. Both my upper and lower limits for reserve growth reveal an increase above what I favored last May. The outcome is more liquidity than seems desirable.

Although Fall seasonal demands for bank credit and the current upward pressure upon bill rates might preclude an immediate dampening of this high rate of liquidity creation, the passage of the seasonal need for funds will permit its correction.

My third test has to do with bank-credit availability. In contrast to the reserve test, bank credit expansion does appear to have moderated. To meet loan demand, banks have, since May, liquidated $3.7 billion (seasonally adjusted) of government securities. On the other hand, credit availability has not been reduced to the point where discountings are heavy, or where banks are becoming noticeably more selective in the quality of their lending. Therefore, this third test also suggests that this Committee might appropriately reduce reserve availability when seasonal pressures permit.

Mr. Balderston concluded by saying that, in the meantime, he would favor continuing the policy of the past three weeks.

Chairman Martin said that he felt more comfortable about monetary policy at present than he had for a long time. Unlike Mr. Mills, he thought history would say that at this juncture the System had made a commendable contribution to a difficult problem. With the Thanksgiving holiday approaching, he considered the present a poor time to make small changes in money market conditions, and he noted that the discussion had been concerned with only minor changes in one direction or the other. He could not agree with charges of rigging or pegging, although it could be said that the Committee was always engaged in pegging to some extent by the very nature of its operations. He doubted that the Committee had too much influence on some of these things.

At the moment, Chairman Martin continued, he thought everything was going in the Committee's favor. He was more optimistic than some of the people around the table about business. Activity was expanding, and the volume of unutilized plant capacity that could pay its way was getting very small. He also was more apprehensive than some people about prices. While he did not attach great importance to incidental cases of mark-ups, about some of which he had heard recently, this was the way an inflationary process began. He thought the price indexes always tended to lag behind actual price changes; inflation could be unnoticed for a period and then suddenly become evident in the indexes.

The unemployment statistics did not indicate adequate response to the stimuli that were being applied, Chairman Martin said, but he thought he could detect some improvement in the situation. For example, in many areas casual labor was now being picked up, unlike a few months ago.

With respect to international developments, U. S. exports were at a high level, and there was less pressure on investors to put funds abroad.

In sum, Chairman Martin said, he thought things were going the Committee's way at the moment, and he would hesitate to see the Committee press its luck too far. It was his personal view that no change should be made in policy and that the directive should be modified only by deleting the Treasury financing reference. There might be difficult problems in the money market over the Thanksgiving holiday and he would want to observe developments for another three weeks before deciding whether to move in either direction. For the first time in a long while, he thought the Committee might soon find itself faced with the possibility of serious problems with prices and with an incipient expansion at an unsustainable rate. He hoped the Committee would not reverse a policy which he felt had, by and large, been successful. He would reiterate a view he had expressed before: the recent lessening of ease had helped both the domestic business situation and the balance of payments. He thought there was no particular reason to be discouraged at the moment nor to lean on monetary policy as a stimulus or a crutch.

The Chairman then proposed that the Committee vote on a policy directive identical to the one issued at the previous meeting except for deletion of the reference to Treasury financing.

Thereupon, on 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 Account in accordance with the following current economic policy directive:

It is the Federal Open Market Committee's current policy to accommodate moderate growth in bank credit, while maintaining conditions in the money market that would contribute to continued improvement in the capital account of the U. S. balance of payments. This policy takes into consideration the fact that domestic economic activity is expanding further, although with a margin of underutilized resources; and the fact that the balance of payments position is still adverse despite a tendency to reduced deficits. It also recognizes the increases in bank credit, money supply, and the reserve base of recent months.

To implement this policy, System open market operations shall be conducted with a view to maintaining the degree of firmness in the money market that has prevailed in recent weeks, while accommodating moderate expansion in aggregate bank reserves.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bopp, Clay, Irons, Mitchell, Robertson, Scanlon, and Shepardson. Vote against this action: Mr. Mills.

Mr. Hayes commented that his vote in favor of this action might appear inconsistent with the views he had expressed earlier. He had modified his position, he said, because he had been impressed by the arguments at the meeting in favor of adopting a wait-and-see attitude. He agreed with Mr. Scanlon that after another three weeks the Committee might find it necessary to change its policy. He also felt there was some misapprehension at the meeting on the position of European governments with respect to their use of monetary policy. He thought the Europeans would be influenced principally by their own situations, and not so much by what this country did. Moreover, he thought it incorrect to say that there was a complete parallelism of interest between the Europeans and this country with respect to upward movements of interest rates, since our balance of payments with Europe was still sharply adverse.

Mr. Robertson said he had voted in favor of the directive adopted because he thought the language was adequate to encompass his views. He expressed some doubt, however, that the directive would be construed consistently with his thinking.

Chairman Martin asked whether there was any objection to the earlier suggestion by Mr. Stone for revising the continuing authority directive to direct the New York Bank not to exceed $1 billion in the change in the aggregate amount of U. S. Government securities held in the System Open Market Account during any period between meetings of the Committee, and no objection was expressed.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, section 1(a) of the continuing authority directive to the Federal Reserve Bank of New York was amended to read as follows:

> To buy or sell United States Government securities in the open market, from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing United States Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account (including forward commitments, but not including such special short-term certificates of indebtedness as may be purchased from the Treasury under paragraph 2 hereof) shall not be increased or decreased by more than $1 billion during any period between meetings of the Committee.

Chairman Martin suggested that the item on the agenda pertaining to the question of making available minutes of the Federal Open Market Committee for some past period for use of scholars and others once again be held over until the next meeting, and there was no objection.

Chairman Martin then referred to the tentative schedule of meetings of the Federal Open Market Committee for the remainder of 1963 and for 1964 that had been distributed at the previous meeting, and asked for comments. Mr. Hayes observed that from time to time he had expressed doubts about the need for the Committee to meet as often as every three weeks on a regular basis. The Chairman replied that the question of the frequency of meetings could, of course, be raised at any time, but he thought it useful for the members to have some idea of the schedule of meetings to expect during the coming year. No objections were raised to the schedule that had been distributed. A copy of this schedule has been placed in the files of the Committee.

It was agreed that the next meeting of the Federal Open Market Committee would be held on December 3, 1963.

Mr. Hayes then summarized for the Committee the status of a Treasury Department program intended to revise and improve statistical reporting on foreign loans by major U. S. banks.

Thereupon the meeting adjourned.

Secretary