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, October 20, 1964, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Daane
Mr. Hickman
Mr. Mills
Mr. Mitchell
Mr. Robertson
Mr. Shepardson
Mr. Shuford
Mr. Swan
Mr. Ellis, Alternate for Mr. Wayne

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

Messrs. Bopp, Clay, and Irons, Presidents of the Federal Reserve Banks of Philadelphia, Kansas City, and Dallas, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Brill, Furth, Grove, Holland, Jones, Koch, Mann, and Ratchford, 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
Messrs. Garfield and Partee, Advisers, Division of Research and Statistics, Board of Governors
Mr. Reynolds, Associate Adviser, Division of International Finance, Board of Governors

Mr. Axilrod, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, General Assistant, Office of the Secretary, Board of Governors

Messrs. Heflin and Patterson, First Vice Presidents of the Federal Reserve Banks of Richmond and Atlanta, respectively
Messrs. Holmes, Eastburn, Taylor, Baughman, Parsons, Tow, and Green, Vice Presidents of the Federal Reserve Banks of New York, Philadelphia, Atlanta, Chicago, Minneapolis, Kansas City, and Dallas, respectively
Mr. Meek, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on September 29, 1964, were approved.

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period September 29 through October 14, 1964, and a supplemental report for the period October 15 through 19, 1964. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Coombs said that the gold stock remained unchanged again this week and the Stabilization Fund had a gold balance of slightly more than $200 million. On the basis of actual and prospective orders, the Stabilization Fund would end the month with a balance of slightly less than $160 million. On the London gold market, private buying had continued to absorb all of the current flow of newly-mined gold. During September the Gold Pool had been unable to acquire any gold at all, and so far in October it had been necessary to dip into the $40 million reserve to the extent of $5 million in order to prevent the market price from rising further. The Russians remained out of the market despite the attractiveness of the current price of roughly $35.12.

On the exchange markets, Mr. Coombs said, there had been recurrent selling pressure on sterling. During September the British experienced an over-all reserve loss of $230 million, of which $185 million was offset by net drawings of $20 million on the Federal Reserve swap line and $165 million on seven other central banks. So far in October, the Bank of England had drawn a further $100 million on the Federal Reserve swap line for a total of $135 million, and shortly before the month-end it would probably make further drawings on various European central banks and the Bank of Canada. He thought it probable that the Bank of England would use some of those prospective drawings on other central banks to pay down part of their drawings on the Federal Reserve, so as to maintain a pattern of roughly proportional drawings on each source of short-term credit.

Mr. Coombs commented that the availability of such short-term credit facilities had played a most useful role in restraining a massive speculative drive on sterling such as had occurred in 1957 and 1961. The problem faced by the new British government, however, went far beyond defending the pound against speculative pressure. As the committee knew, for a number of months now the British trading position had been deteriorating. Imports had risen sharply, which could reflect a fair amount of precautionary buying against the background of statements by both Conservative and Labor party officials that they might have to resort to import controls. Of much greater concern, however, had been the disappointing trend of exports, despite continuing price stability in the United Kingdom and rising prices in many of its overseas markets. Mr. Coombs thought it likely, therefore, that the new government might soon find itself compelled to take some pretty drastic action, possibly a combination of a Bank rate increase plus the introduction of some temporary import surcharges, or similar measures. Meanwhile, there might be still further British use of the Federal Reserve swap facility as well as other central bank credit lines, with a subsequent funding of those credits, if necessary, by a sizable drawing on the International Monetary Fund.

In other markets, Mr. Coombs remarked, buying pressure on both the Dutch guilder and the Belgian franc had continued, mainly attributable to a credit squeeze in both countries. In both countries, however, there was a growing recognition that the credit squeeze was proving self-defeating, and he hoped that alternative policy approaches would soon be developed.

In reply to questions by Messrs. Swan and Ellis, Mr. Coombs said that the situation in the London gold market had changed recently. Earlier, this market had been a major source of gold; more than $300 million had been acquired through it by the U. S. Treasury during the first half of the year, and nearly $50 million in July and August. However, during September none at all had been acquired, and in October the Pool was in deficit. Some possible problems might be ahead unless the Russians found it necessary to sell gold over the rest of the year. In part the change in the situation reflected a decline in the supply of gold, since the Russians had been out of the market. But the main problem was the increase in speculative buying, which continued heavy day after day. Such buying was not surprising in view of the political and economic uncertainties in the world. It might come to an end if some of those uncertainties were clarified; otherwise, the situation might well get worse.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System open market transactions in foreign currencies during the period September 29 through October 19, 1964, were approved, ratified, and confirmed.

Mr. Coombs noted that the $100 million standby swap arrangement with the Bank of France would reach the end of its three-month term on November 6, 1964. He recommended its renewal for another three months.

In reply to Mr. Deming's question as to whether the Bank of France was interested in lengthening the maturity of the swap line to twelve months, Mr. Coombs said he had not approached the French on the matter, preferring to wait until all of the other swap arrangements were on the longer basis.

Mr. Robertson suggested that it might be desirable for the Committee to authorize an extension of maturity to twelve months, so that Mr. Coombs could complete the negotiations on that basis if the French indicated a preference for the longer term.

Mr. Mills said he thought there was a useful discipline in asking Mr. Coombs to come back to the Committee for such authority. As he looked at the other proposals which Mr. Coombs had indicated by memorandum that he would make today, he thought the Committee might well want to consider whether it was surrendering a greater degree of authority to the Manager than was consistent with its own responsibilities. These transactions were complex and difficult to follow, and he felt that they should come before the Committee as often as possible, so that the Committee would understand fully what was being done.

For example, Mr. Mills continued, a recommendation would be made today to increase the swap line with Belgium. The situation there was parallel to that in France and the Netherlands; each of these countries was drifting into recession with tight money market conditions and deficits in their international payments. Despite the fact that these countries were moving into circumstances in which they should be making requests of the United States, this country would be asking them to grant a request for expanding the swap facility. Mr. Mills thought this was unbecoming to the United States and diplomatically undesirable. In his opinion the U. S. should deal from strength not weakness. The Belgian inflow of dollars had come about very largely out of necessity on their part; they had borrowed from New York banks. He did not understand why the System should request them to expand the swap arrangement when the difficulty lay with them and not with the United States.

Commenting on Mr. Robertson's suggestion, Mr. Coombs said that he could communicate readily with Committee members by telegram if the French indicated an interest in extending the maturity of the swap arrangement to twelve months. Accordingly, he did not think it necessary to request authority for such an extension of term today. Chairman Martin suggested that the Committee hold the question of term extension in abeyance, and vote on the recommendation for renewal of the arrangement for another three months.

Renewal of the swap arrangement with the Bank of France for a further period of three months, as recommended by Mr. Coombs, was approved.

Mr. Coombs then noted that swap drawings on the Netherlands Bank in the amount of $20 million and $10 million would fall due on November 4 and November 10, respectively. Unless there was a quick turn-around in the Dutch payments position, he saw no possibility of paying these off at maturity and, accordingly, requested Committee approval of their extension for another three months. In each case, this would be the first renewal.

Renewal of the two swap drawings on the Netherlands Bank was noted without objection.

Mr. Coombs then noted that the System had now exhausted its holdings of Belgian francs under the $50 million swap with the National Bank of Belgium. The National Bank was continuing to take in dollars. Mr. Hayes and Mr. Coombs had had informal conversations with Belgian officials at the last meeting of the Bank for International Settlements as to the best way of handling the situation. In these conversations the Belgians had indicated that they would be agreeable to increasing the standby swap arrangement from $50 million to $100 million and to extending such a standby swap arrangement to a full twelve-month term. Whereas the existing $50 million swap line had been fully drawn from the beginning, the Belgians would prefer to place the additional $50 million on a standby basis until drawings became necessary. In general, Mr. Coombs thought that the swap line with the Belgian National Bank had been on the low side, and that the recommended increase to $100 million would bring this arrangement into better alignment with the others.

As Mr. Mills had indicated, Mr. Coombs continued, part of the dollar inflow to Belgium had resulted from their borrowing from New York banks. However, the U. S. had interposed no barriers to such borrowing, nor had it tried to freeze or limit in any way the use of the proceeds. On several occasions in the past when the Belgians had borrowed in New York the Treasury had engaged in a sort of counterpart operation by issuing a bond denominated in Belgian francs to the Belgian authorities, thus avoiding a dollar conversion problem for them. It was probable that the proceeds of their recent borrowing would be disbursed in October and November, so that the operation to some extent was self-reversing. The Belgians pursued a fairly rigid policy with respect to gold and foreign exchange holdings; they had what was tantamount to a 100 per cent gold standard, holding little or no foreign exchange. This created something of a problem for the U. S. since any dollar accruals on their part involved a risk of conversion to gold. On the other hand, they had proved cooperative during this period, drawing no gold from the U. S. from mid-1962 until last week. And they had been helpful indeed in various international negotiations.

Mr. Mills remarked that he would approve the recommendation with reluctance because he felt that the negotiations had gone beyond the point at which they could be nullified without embarrassment to the Special Manager. However, as he had indicated on other occasions, he would hope that in the future negotiations would not be carried to this point until an understanding had been reached with the Committee.

Mr. Coombs said he would feel no embarrassment whatever if the Committee should disapprove this recommendation. The discussions with the Belgians had been of the informal sort continually held with countries in the swap network, concerning such questions as whether the swap lines were at appropriate levels. The Belgians had indicated only that they would be willing to increase the size of the swap line if the System thought that desirable. If the Committee decided not to do this and the Belgians bought gold or made some other adjustment he would not be personally embarrassed. Mr. Hayes said that his position was identical with that of Mr. Coombs.

Mr. Daane said the recommendation seemed to him to be in accordance with the intent of the Committee and with the best interests of the United States. The question was whether the Committee wanted to take this additional insurance for protecting the U. S. gold stock, and in his judgment the answer should be yes.

Mr. Deming asked what the advantage was of having half of the swap line fully drawn and half on a standby basis. Mr. Coombs replied that he would have preferred to have the whole line on a standby basis, as was the case with other swap arrangements. The initiative for the agreement under which the original arrangement had been fully drawn from its inception had come from the Belgians, for reasons that might have been related to their high gold ratio. Under the fully-drawn arrangement they had access to a source of foreign exchange for use on a day-to-day basis. Mr. Hayes added that he thought the Belgians might encounter certain administrative difficulties if they attempted to unwind the original arrangement, but they would like any supplement to the swap line to be on the same basis as were those with other countries.

> An increase in the swap arrangement with Belgian National Bank to $100 million, with extension of term from six to twelve months, as recommended by Mr. Coombs, was approved.

Mr. Coombs then noted that the Committee had received his memorandum dated October 16, 1964, recommending an expansion of the authorizations relating to forward currency operations to include forward sales of authorized foreign currencies. (A copy of this memorandum has been placed in the files of the Committee.) As the memorandum indicated, good results had been obtained from such transactions undertaken for Treasury account in German marks, Swiss francs, and Dutch guilders. He thought the Committee might well find it desirable to engage in such operations in the months ahead. As noted in the memorandum, the risk incurred by the System in undertaking such operations was that of a revaluation of the foreign currency, and was no different from the risk incurred in drawing on a swap line. In both cases, the Committee could protect itself against such a risk by placing standing orders on the foreign central bank to protect its short positions against revaluation of the foreign currency concerned. If the Committee were to approve this request, Mr. Coombs said, appropriate amendments to the continuing authority directive and to the Guidelines would be required, as indicated in the memorandum.

Mr. Mills asked whether transactions of this sort fell within the surveillance principle that had been adopted by the Group of Ten. Mr. Coombs replied that the concept of multilateral surveillance was not precise, and efforts now were being made to delineate it better. Swap drawings were reported to the Governors at Basle, but he thought it was highly unlikely that other central banks would want to report forward operations. In general, central banks considered forward operations to be among their most closely held secrets. He would recommend that any such operations conducted on behalf of the Committee should not be reported to the Governors at Basle.

Mr. Daane added that the discussions on multilateral surveillance involved such matters as compatibility in the form of the reports made by the various countries. To his knowledge there had been no suggestion that forward operations should be subjected to multilateral review.

Mr. Mitchell said he thought the capacity of market participants to evaluate events would be impaired if the Committee were to start tinkering with the market. As he understood the Committee's past position, it had been prepared to use forward operations only on an extremely limited basis, and, in principle, only to stop outflows. It might be useful, he said, to explore briefly the sort of situation in which the Special Manager would use the authority. For example, would he expect to use it to induce a flow of funds into this country?

Mr. Coombs replied that he thought the rationale of operations would be as follows. Assuming that interest rates differed in two countries, forward exchange rates for the currencies of those countries ordinarily would tend to a position at which the two interest rates were equalized on a covered basis. Where this tendency worked out in practice there would be no reason to attempt to create artificial conditions for the sake of inducing flows. Intervention might be desirable only in cases where the forward exchange rate had got out of line with interest rate differentials, or where the forward rate had moved in response to speculation on a possible revaluation of the foreign currency.

There had been two recent instances of the latter situation, Mr. Coombs said. In the spring of 1961, following the revaluation of the German mark, the forward rate went to a premium of as much as 4 per cent, as a result of market expectations of a further revaluation. At that rate, pressures on the dollar became a serious threat. Through joint operations of the U. S. Treasury and German Federal Bank, the rate had been brought down to about 1 per cent. These operations conveyed official assurance that the mark exchange rate would be unchanged for at least 90 days. The operation was successful, and it was completely liquidated in a relatively short time. In February of this year the New York Bank conducted a similar operation for U. S. Treasury account when there again were active rumors of a revaluation of the mark. This time it took a smaller volume of forward sales to reassure the market.

This, Mr. Coombs said, was essentially the kind of operation he had in mind--one of preventing the forward rate from getting out of line with interest rate relationships, and thus minimizing, and perhaps even reversing, flows into the foreign currency. He would consider such operations to involve corrective therapy for abnormal situations rather than the creation of artificial conditions for the sake of forcing flows in a direction they would not follow under more normal circumstances.

Mr. Mitchell asked if the Treasury planned to discontinue operations of this type or if it felt its resources were inadequate, and Mr. Coombs replied in the negative to both questions. The Treasury had been quite satisfied with the operations that had been conducted. Nor was the issue one of resources; the Treasury had no specific dollar limits to its forward operations, other than those imposed by the size of the Stabilization Fund, and at present their forward position was reduced from past levels. If the proposed authority was granted it would be the final step toward making the Committee's operations coterminous with the Treasury's; except in this case, existing authorizations permitted operations on behalf of the Committee of all types in which the Treasury engaged. In his judgment it was desirable for the two agencies to be able mutually to reinforce each other's actions.

Mr. Daane said that with the uncertainties existing abroad it seemed to him appropriate for the System to be able to act side by side with the Treasury as specific situations developed.

Mr. Mitchell said that he did not object to this aspect of the proposal. What made him uneasy was the possibility that the Committee would be papering over difficulties, and concealing from people who had a legitimate concern with the market facts they otherwise could read in market performance. He agreed that market participants often were wrong in their judgments, and took speculative positions that clearly were off base. He thought the Committee should do whatever it could to correct such situations. But how could one differentiate between such cases and others in which the Committee might be trying to do something of a much more marginal nature? How would the Committee know whether the objective in a particular operation was one it could support?

Mr. Robertson said that he shared Mr. Mitchell's belief that the Committee should not edge into a situation in which it was tinkering arbitrarily with the market. He suggested that the Committee approve the recommendation on an experimental basis, the authority to be used sparingly with the understanding that the Special Manager would give the Committee a full accounting of the nature and results of every action taken under the authority.

Mr. Coombs commented that the Committee now got a full accounting on all operations, and he was not suggesting any change in this procedure. As for giving information to the market, a complete report was made every six months. He did not think there was a risk of misleading market participants by the proposed forward operations; it would simply be made clear that the authorities did not want a forward rate to go beyond some given point. As for the suggestion that the authorization should be used sparingly, he would expect to use it primarily in dealing with a sudden boiling up of pressures, such as might arise if people thought there was a clear risk that a certain foreign currency might be revalued. If the New York Bank, with the agreement of the foreign central bank involved, could step in and offer the foreign currency forward, it could have a major impact by providing the assurance the market was looking for.

In response to other questions, Mr. Coombs said that he would expect to undertake forward operations of the type proposed exclusively in the interest of the dollar and not to protect a foreign currency; and that he would not expect to engage in such operations to deal with market worries about devaluation, as distinct from revaluation, of a foreign currency. He also observed that it was not possible to specify in advance how large a covered interest rate spread would represent a sufficient degree of disequilibrium to require action. This would depend on the circumstances of the particular case, and he would anticipate that both clear-cut and marginal situations would arise.

Further discussion mainly concerned the types of limitations that should be placed on forward operations. Among the matters discussed were the appropriate dollar limits for such operations, the question of whether it was preferable to continue to specify a single dollar limit for all forward operations taken together or to establish separate limits for operations of each authorized type, and the question of whether it would be desirable to require the

Manager to obtain advance approval for each use of the newly proposed type of forward operations, with limits set to both the time period and the dollar amounts in which they could be undertaken.

In the course of this discussion, Mr. Mitchell said he felt that under the proposal the Committee would be authorizing operations of a sensitive type in a sensitive market without adequate guidelines to the Special Manager and without sufficient control over his activities. He would prefer to have the authorization less open-ended.

With respect to the question of dollar limits, Mr. Coombs noted that the Committee already had authorized forward operations for three purposes with a combined limit of $150 million. If the recommended fourth type of forward operation was approved, it was proposed to increase the combined limit to $200 million. He would not expect to use this amount entirely in connection with the new type of forward operation because of the desirability of leaving scope for the other three types.

Mr. Hayes commented that setting a combined limit probably was a more conservative approach than specifying separate limits for each type of forward operation, since the aggregate likely to be considered necessary would be greater under the latter procedure. He added that the proposed limit of $200 million was relatively small compared, for example, with the size of the authorized swap lines.

Mr. Daane observed that in his judgment it would be undesirable to require advance approval for specific operations since the situations requiring action might arise quickly and unexpectedly. Advance approval also was unnecessary, in his opinion, because he had confidence in the Special Manager's judgment which he was sure the Committee shared. Moreover, the Committee was protected against the possibility of undesirable operations by the dollar limits that would be set, and by the fact that the Special Manager would continue to make regular, full reports.

Chairman Martin remarked that the Treasury had been engaging in operations of this sort since early 1961, but they would be a pioneering type of activity for the System and he thought it desirable that members should raise any questions they had at this time. If the requested authority was approved it was possible that the Committee might decide after experience to withdraw it. The approach recommended by Mr. Coombs seemed reasonable to him, including the suggested combined limit of $200 million, although it was difficult to say in advance what the appropriate dollar limits would be.

In a final comment, Mr. Coombs said he would assume that any operations undertaken would be conducted in parallel fashion with the Treasury, and it would be his intention to use the authority sparingly. He thought the Committee should be under no illusions, however, with respect to one matter: once an operation of this type was undertaken to deal with a specific disturbance, there could be no holding back, since a commitment would have been made. The System's participation would be limited by the $200 million maximum, and by the need to preserve part of that sum for possible use in forward operations of other approved types. Therefore, if in a particular case the appropriate amount had been employed by the System, the Treasury's part of the operation might well balloon.

Mr. Young observed that if the proposed subparagraph (d) was to be added to the continuing authority directive for foreign currency operations, it would be desirable to revise the language of the present subparagraph (c), by the insertion of the word "concurrent" before the word "sales " to clarify the distinction between the types of operations contemplated by the two subparagraphs.

Chairman Martin noted that another amendment to the continuing authority directive was in order. It had been the Committee's practice to specify, in the first paragraph of the directive, a dollar limit on the aggregate amount of foreign currencies held under reciprocal currency arrangements of an amount equal to the sum of the authorized individual swap arrangements. Earlier today the Committee had approved an increase in the arrangement with the National Bank of Belgium from $50 million to $100 million. Accordingly, it would be desirable to change the aggregate limit from $2.05 billion to $2.1 billion.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the Committee approved an amendment, recommended by Mr. Coombs in his memorandum of October 16, 1964, to the Guidelines for System Foreign Currency Operations, as reaffirmed by the Committee on March 3, 1964, in which the following second paragraph of Section 1 of the Guidelines was deleted:

Holdings of a currency shall generally be kept sufficient to meet forward contracts in that currency (exclusive of contracts made under parallel arrangements with foreign monetary authorities which provide their own cover) expected to mature in the following 3-week period.

Upon motion duly made and seconded, and by unanimous vote, the following continuing authority directive to the Federal Reserve Bank of New York with respect to foreign currency operations was approved:

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 3, 1964, as amended October 20, 1964; provided that the aggregate amount of foreign currencies held under reciprocal currency arrangements shall not exceed $2.1 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 $200 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;
(c) purchases through spot transactions and concurrent sales through forward transactions, for the purpose of restraining short-term outflows of funds induced by arbitrage considerations; and
(d) sales through forward transactions, for the purpose of influencing interest arbitrage flows of funds and of minimizing speculative disturbances.

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.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering open market operations in U. S. Government securities and bankers' acceptances for the period September 29 through October 14, 1964, and a supplemental report for the period October 15 through October 19, 1964. Copies of these reports have been placed in the files of the Committee.

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

> The firmer money market atmosphere achieved several weeks ago was generally maintained during the recent period except for the aberration that occurred over the Columbus Day holiday, when float--as it often does at that time of the year--acted perversely indeed. The bill rate edged upward as the three-month issue moved from December to January maturity dates and as the firmer money market conditions and the attendant higher cost of carrying positions exerted their effects. In yesterday's auction, the three-month bill was sold at an average rate of about 3.59 per cent, up 3 basis points from the auction three weeks ago.
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> The Treasury bond market has undergone a gentle downward drift in prices over the past three weeks in response to renewed uncertainty over the course of monetary policy, and hence over the course of interest rates, during the balance of the year. The fact that the price declines have been small and gradual despite considerable discussion of the possibility of a shift in credit policy toward less ease and despite the occurrence of potentially unsettling international events is, I think, evidence of the underlying firm position of the market. A number of factors give rise to this position. Dealer inventories are in good shape, although the market would be on more solid ground if there were further reductions in the over-20 year area, where $115 million are still held; there has been little or no urgent selling by banks and other investors despite circumstances that might have triggered such selling; the Treasury has indicated that it will confine its financing to the short-term area over the remainder of the year; the volume of forthcoming public offerings of new corporate and municipal issues is relatively light, although private

placements are taking up some of the slack; and finally, the market continues to pay a great deal of attention to forecasts of a continuing large flow of savings that will be seeking investment outlets and to the prospect that the volume of available mortgages may continue below earlier levels.

Turning to Treasury financing, an auction of $1.5 billion March tax anticipation bills will be held today. Next week the Treasury will announce the terms on which it will refund $8.7 billion of November 15 maturities, only $2.3 billion of which are held by the public. The Treasury is expected to issue a short-term note in a cash refinancing operation; the books will probably be open only on November 2, the day before the election. Barring some unexpected event, the operation should be a relatively routine one. Shortly after the election, the Treasury may, depending on its cash position, announce an issue of $1.5 billion tax bills maturing in June.

There has been a good deal of discussion recently of the practice initiated by a major New York bank of paying a rate above the discount rate for Federal funds. The payment of 3-5/8 per cent for funds has been rather sporadic, and the amounts of funds traded have been quite small relative to the amounts traded at 3-1/2 per cent. I suspect that the practice will continue to be of only limited significance unless monetary and credit conditions should at some point become substantially tighter than they now are. In general, a bank would be willing to pay more than the discount rate for Federal funds either as an alternative to going to the discount window, or as a means of acquiring additional funds to re-lend in short-term outlets. A bank would use the device as an alternative to the discount window only if it had been borrowing there rather continuously and had been subjected to some of the discipline of the window, or if it had a shortage of eligible collateral to put up against loans from the Reserve Banks. I do not believe that either of these conditions is widely prevalent under present circumstances. We come, then, to the acquisition of funds above the discount rate for the purpose of re-lending them at short-term. The most likely outlet for such funds is dealer loans. But for any great volume of funds to be bought above the discount rate for that purpose would require a combination of heavy dealer positions and a particularly short supply of money from the dealers' usual out-of-town

> lending sources. This combination of circumstances will recur from time to time even under present money and credit conditions; but it is not likely to exist continuously unless and until there is a significant tightening of money and credit. If and when we do find a large volume of funds trading above the discount rate with great frequency, the administration of the discount window will of course become more difficult.

Mr. Stone added that projections at both the New York Bank and the Board indicated that it would be necessary to supply a substantial volume of reserves in late October and early November--perhaps on the order of $1--1-1/2 billion. In considering ways in which such needs might be met, the possibility was raised of supplying $400 million of reserves by a temporary reduction in the Treasury balance, from the level of about $900 million near which it had been held recently to the earlier average level of about $500 million. Such a reduction would have the advantages over bill purchases of minimizing downward pressures on short-term rates and of reducing the System's required gold reserves. It was his understanding that the Treasury was prepared to cooperate if such an operation was considered desirable.

Mr. Swan asked what factors underlay the Treasury's decision to allow a 50 per cent tax and loan account credit on the issue of March tax anticipation bills.

Mr. Stone replied that the Treasury announcement of this bill issue had been made on the preceding Wednesday, the day before the British elections were to be held. It had seemed possible that a

Labor Party victory, particularly if the margin was sizable, might lead to a speculative attack on sterling and a consequent increase in Bank rate. This in turn, it was thought, might suggest to the market that sooner or later the Federal Reserve discount rate might be increased. In view of these possible causes of market weakness, the Treasury thought it prudent to take out some insurance by allowing the 50 per cent tax and loan account credit.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period September 29 through October 19, 1964, were approved, ratified, and confirmed.

The staff economic and financial review at this meeting was in the form of a visual-auditory presentation. Copies of the text of the presentation and of the accompanying charts have been placed in the files of the Committee.

The introductory portion of the review, presented by Mr. Noyes, was as follows:

> As you will all recall, earlier this year the staff presented an analysis of Administration views on 1964 economic prospects and attempted to assess the kinds of financial pressures that such unfolding economic developments might generate. Recent developments in the economy seem to be stimulating sufficient uneasiness--even before the developments of the past week--to make an evaluation of differences between actual and projected events appropriate at this juncture.

Over all, the economy has been performing close to the target of substantial growth at reasonably stable price levels. Conflicting trends within the totals are evident, however, and there is no agreement as to just what the next move will be.

Some observers read the downturn in housing and the leveling off in Federal spending as portending a general slowing up, likely to be succeeded by a downturn late next year barring some new stimulus.

Others, noting the rise in some materials prices, the widening pressures on capacity, substantial wage settlements, and strong business investment demands, feel these imply a speculative binge in the near term, which might also eventuate in a downturn next year but reach it through a more disastrous route.

And finally, there are the eternal optimists who think the economy may be able to continue along its recent growth path but still maintain reasonable stability in prices for quite some time to come.

It is not our purpose this morning to present a staff choice from among these alternatives. Rather, our effort will be directed at analyzing the cross currents tugging at the economy, and at suggesting the kinds of adjustments that may be necessary to keep the economy headed in the right direction at the right speed. With this, we will try to picture a pattern of financial developments that would be consistent with an economy continuing to move gradually toward fuller employment of resources without succumbing to inflationary pressures. We begin with a review of major developments in incomes, spending, and financial markets so far this year by Mr. Garfield.

The concluding portion of the review, presented by Mr. Brill, was as follows:

Before turning to the policy implications of this analysis, let me review briefly the ground we have covered--and the ground we have avoided. We have not presented a staff forecast. Rather, our effort has been to call attention to the major financial and nonfinancial forces threatening sustainability of the expansion, and to suggest one pattern of orderly expansion.

At the risk of oversimplification, the analysis may be summarized as follows: Principal immediate threats to sustainability lie in the possibility of a rapid acceleration of business inventory buying, particularly of steel, and also in the possibility of wage increases exceeding productivity gains. These forces can interact, with the fear of excessive wage settlements or interruptions to supply stimulating hedging purchases for inventories, and the resultant pile up of new orders reducing business resistance to wage demands.

This does not mean, however, that inventory building must stay at the low rate of recent months to avoid significant price pressures. A moderate increase in the rate of stockpiling is not only consistent with price stability, but possibly a necessary concomitant of expansion, given the exceptionally low current stock/sales ratios. We must also distinguish between wage increases which stay within productivity boundaries, and those settlements which exceed the capacity of the industries affected to absorb them without price increases. Moreover, it is widespread cumulative price changes that are to be avoided as damaging to balanced expansion; selective increases and decreases are essential to the production adjustment process in a free market economy. Our concern is directed to excesses in both inventory policies and wage settlements, excesses which fortunately remain only potentialities at the moment.

But our concern is directed also to another threat to sustainability, namely, the possibility that final demands for output may not advance enough to validate either projected plant expansion or expected growth in the labor force. A major contribution to continued growth will need to come from business spending for fixed capital, given present trends in Government spending and residential construction. Will the markets be there to meet expanded productive capacity?

With incomes rising at a slower rate than earlier, consumers would have to spend a larger share of income than usual in order to clear goods markets as new productive capacity comes on stream. The problem is hardly a new one; one readily recalls the experience of 1956-57 when sluggish final demands, at a time when installation of new capacity was continuing at a high level, resulted in a declining rate of capacity utilization.

The projection shown for the balance of this year and early 1965 could be realized if business, labor, and consumers display both the prudence and confidence needed to avoid excesses or shortfalls. All participants have learned from the 1955-57 experience and its consequences, and from the major structural shifts since then, particularly the increased possibility of foreign and interproduct competition and the decline in job opportunities in major industries. These are as evident to business and labor leaders as they are to economists. The possibility that appropriate adjustments will be made in business and consumer spending patterns, and in business and labor pricing policies, is thus a real alternative.

What sort of financial picture would likely ensue from the course of economic activity portrayed? In terms of credit market developments, total financing would decline, as Federal borrowing needs are reduced. With respect to private borrowing, the picture is similar to the moderate growth we have seen over the past year. These needs could be met at approximately stable rates of interest without any drastic alteration in the rate of expansion of bank credit.

Among the significant prospective developments to which we called attention is the projected growth of the money supply. Even in the context of relatively moderate total credit demands and the relatively moderate expansion in bank credit projected, money supply increases could continue considerably larger than in recent years, reflecting the changes in asset needs and preferences discussed earlier by Mr. Holland.

A consequence of these changes would be a substantial increase in reserve needs, in effect reversing the situation earlier in this expansion when the System could meet the public's preference for time and savings deposits rather than demand balances with minimal reserve additions. The test of whether these increased reserve needs <u>should</u> be met is the public's use of the credit and money created by the additional reserves. So long as economic expansion and price stability are maintained, as the projection suggests is possible, shifts in asset preferences need not occasion shifts in monetary policy. Indeed, if the economy can clear the immediate hurdle of steel wage and price determination, and international capital flow considerations permit, we may find it appropriate subsequently to be thinking of possible needs for more stimulative policies.

Following the presentation, Mr. Mitchell asked whether there was any evidence to indicate the extent to which the recent low rate of inventory accumulation was involuntary. Mr. Brill replied that inventory growth so far this year had fallen short of the amount reported as planned in the business anticipations survey conducted by the Department of Commerce. This implied that the low rate of accumulation was to some extent involuntary. However, there had not yet been enough experience with this survey to permit a confident interpretation of the differences between prior plans and actual performance at different stages of the cycle.

Mr. Shepardson asked whether the involuntarily low inventories reflected supply shortages or higher than expected sales. Mr. Brill replied that as far as he was able to determine supply shortages were limited to a few lines, such as nonferrous metals and, recently, autos. For the most part he did not think inventory developments reflected supply shortages.

Mr. Hayes asked whether there hadn't been a more general trend than the presentation had suggested toward price increases for products of industrial importance. It was his impression that the preponderance of announced price changes in the past month or so had been on the up side.

Mr. Garfield commented that the index of sensitive materials, prepared at the Board, had shown a substantial rise in the 1955-1956 period and a lesser advance in 1959. This year, however, the index had increased relatively little, and only to early spring; in the last few months it had shown no change. This was because prices of some included items, such as lumber and plywood, had been tending down, and prices of others were unchanged. On the other hand, the BLS index of basic materials prices had risen sharply recently--in fact, by three-fourths as much as it had in 1955-57. This index covered only 13 commodities, of which 4 were nonferrous metals. Thus, it was heavily weighted in the area in which recent price increases had been concentrated.

It did seem, Mr. Garfield continued, that one saw announcements in the press of new price increases every few days--for example, in particular paper products--and yet when one consulted the BLS index of paper product prices he found it substantially unchanged. The explanation was that many of the announced price increases had not actually been made effective. Paper producers kept trying to raise prices, but they had encountered real resistance. In the area of fuels, to cite an example of a different type, there had been price declines. Despite high levels of activity in petroleum production, product prices were lower now than they were a year ago.

Mr. Balderston asked how the projection of a decline in the growth rate for funds advanced by banks could be reconciled with the projection of a rise in the growth rate of bank reserves and the money supply.

Mr. Holland replied that part of the reconciliation lay in the projection of an increase in the growth rate for demand deposits but a decline in the growth rate for time deposits, with a corresponding dampening of the increase in total deposits. Since reserve requirements were higher for demand deposits, a step-up in the rate at which reserves were supplied would be required to maintain the growth rate in total deposits.

Mr. Brill added that the projection also incorporated an estimate that the Treasury balance would be reduced significantly by the end of the 1965 fiscal year. The combination of a more rapid growth in private demand deposits, a slower growth in time deposits, and a decline in Government deposits implied a slower rate of expansion in bank assets.

Chairman Martin then 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:

> The business situation is basically unchanged since our last meeting, although it does appear that the inflationary dangers already noted at that time are becoming

somewhat more clearly visible. On the price front, announcements of specific increases have been fairly numerous and have included such important products as sulphuric acid and reinforcing steel bars. Meanwhile, the talk of a general steel price rise is intensifying and is probably having effects on inventory policies. Areas of particular strength in the business picture are automobile sales and steel orders, with the latter affected by anticipatory demand related to the May 1965 expiration of present wage contracts, as well as to possible further steel price increases. The broader business indicators show no real change in the pace of the advance, and construction has been relatively sluggish.

Recent balance of payments data have been subject to sizable revisions, and the third quarter annual rate of deficit is now estimated at about $2.2 billion--somewhat below the second quarter rate but still disturbingly high. October seems likely to produce a large deficit because of the customary heavy flow of United States corporate funds to Canadian banks at the beginning of each quarter. One encouraging aspect of our recent balance of payments has been the continuing favorable trend of exports, with the resulting well-maintained trade surplus. Also, the substantial portion of the deficit attributable to the flow of corporate funds to Canadian banks suggests less difficult problems than if the flow were to Europe; and it is noteworthy that most of this year's over-all deficit has been financed by means of enlarged foreign private holdings of dollars. Yet despite these mitigating factors the payments problem must still be viewed as decidedly serious. It seems quite likely that the British payments difficulties may lead eventually to an increase in the British Bank rate, although the probable timing is by no means clear--nor is it clear how much pressure such a move might put on the dollar.

Bank credit rose during the first nine months of 1964 at an annual rate of 8.2 per cent, a little above the rate of increase for all of 1963. Thus there still seems to be no evidence of a significant slowdown in credit growth, in spite of the various modest changes in monetary policy that have occurred in the last few years. Business loans have grown faster this year than in 1963 or 1962, and some further strengthening of loan demand could take place this autumn. Since loan-deposit ratios at reporting banks outside of New York City are high historically and in relation to current levels at New York City banks, any acceleration in loan demand outside the money centers could be quickly translated into pressure on the money market banks, with somewhat more upward pressure on rates than has been the case in the past. The money and capital markets have been calm in the face of momentous events abroad, but they continue in a rather sensitive state because of expectations of eventual changes toward a less expansive credit policy.

With the Treasury expected to announce the terms of the November refunding about a week from now, we should help to maintain an "even keel" in the money and capital markets during the coming three weeks. By the time of our next meeting our election will be over, the refunding will be close to completion, and we shall have had a further opportunity to assess the strength of inflationary tendencies in this country as well as the economic impact of the British change in government and the outlook for the U.S. balance of payments. While no change in policy seems advisable for the moment, we may well find it prudent fairly soon to try to slow down the rate of bank credit expansion over the remainder of the year, with some consequent firming of the interest rate structure.

For the present no change in the discount rate is desirable. As for the directive, the second paragraph might well be left as it is, but the first paragraph might be modified in recognition of the work stoppage at General Motors, the growing threat to price stability, and the latest developments with respect to bank credit, the money supply, and the balance of payments.

Mr. Ellis remarked that with puzzlement and some concern he reported again that the New England economy seemed to be expanding steadily, although its manufacturing activity, as measured by employment and estimated output, remained on a plateau. Part of his puzzlement traced to the apparent inconsistency between production levels and the evident activity in business investment. The Boston Bank's quarterly survey of manufacturers' experience and expectations, now in tabulation, suggested that this year's outlays in New England would reach the 16 per cent year-to-year expansion reported to the Bank last spring. Statistical evaluation of 1965 expectations suggested a further expansion in outlays for next year. These same manufacturers reported expectations of a 3.5 per cent increase in sales between the third and fourth quarters of this year.

His concern, Mr. Ellis said, traced to the failure of manufacturing employment to grow, to declines in the index of factory manhours, and to the year-to-year stability in factory output totals. Fortunately, nonmanufacturing employment was growing steadily, and personal income through August of this year was 4.6 per cent higher than last year.

Mr. Ellis said that the pressure of strong loan demand, together with a steady influx of time deposits, had led the weekly reporting banks into increasingly less liquid positions. For the most recent week reported (October 7), liquid assets fell to 10.2 per cent of total deposits adjusted compared with 13.2 per cent for all member banks in the nation. Loan-deposit ratios for all New England weekly reporting banks stood at 70.8 per cent, four full points above the national average.

With the national elections just two weeks away, Mr. Ellis said, it clearly was undesirable to launch a monetary policy action that might in itself become a political issue. By the same token, he would hope not to lose ground in the execution of the policy initiated in August. It was reassuring to have the Manager of the Account report that lessened ease showed through the events of the last three weeks. The week ending October 14 probably should be added up as involving a miss on the side of ease--with Federal funds rates slipping on three out of five days, with dealer lending rates easing, and with net free reserves averaging $186 million.

Looking to the immediate future, Mr. Ellis continued, in the absence of overt policy moves, he would urge the targets he had expressed earlier: net free reserves in the zero to $50 million range, member bank borrowings at $300 million or over, the Federal funds rate at 3.50 per cent or better, and short bill rates in the 3.55 to 3.65 per cent range. Looking further ahead, he would anticipate that the November 10 meeting would provide an opportunity for the Committee to reappraise its policy in view of the current sharp and unsustainable rate of credit expansion, a rate far in excess of production and employment gains.

Mr. Ellis urged the Committee to consider discarding the last phrase of the second paragraph of the directive. Given the current strength in the economy, the first phrase, with respect to maintaining the same conditions in the money market, clearly was inconsistent with the second phrase calling for moderate expansion in aggregate bank reserves. The inconsistency would remain, he thought, even if the shift in the composition of deposits shown in the staff projection was realized. Rather than giving the Manager conflicting instructions and requiring him to choose between them, Mr. Ellis preferred to eliminate the second phrase. He found the first paragraph of the staff draft acceptable with possible deletion of the bracketed phrase referring to the settlement in the automobile industry.

Mr. Irons said there had been little change recently in the Eleventh District; economic activity was moving along at about the same general level as in the past few months. Employment was up and unemployment was shading down. Retail trade had risen slightly, and industrial production was down a bit.

On the financial side, Mr. Irons said, there had been declines in loans and demand deposits, but increases in investments and time deposits. District banks still were not in too liquid a position, and they continued to use Federal funds rather heavily, with purchases running at about $650 million a week as compared with sales of about $250 million a week. Both the number of applications at the discount window and the dollar volume of discounts had lessened a bit in the past few weeks.

Mr. Irons recommended a continuation of the Committee's present and immediately past policy. With the uncertainties existing at present it seemed to him to be almost out of the question to make any decisive change. The figures he had in mind were much the same as those Mr. Ellis had mentioned. He would like to see free reserves at around the $50 million level, and he would not be overly disturbed if they trended down to zero or perhaps below zero for a day or so; the Treasury bill rate in the 3.55-3.65 per cent area; and the Federal funds rate at 3-1/2 per cent. Some increase in discounting might develop, he thought. He did not favor a change in the discount rate.

The first paragraph of the draft directive that had been distributed was acceptable to Mr. Irons. He had no strong feelings on whether the bracketed phrase referring to the settlements in the automobile industry should be included or not. He was inclined against deleting the last phrase of the second paragraph, relating to moderate expansion of bank reserves, as Mr. Ellis had suggested. The sense of this phrase was reflected in the first paragraph also, and he did not think that much would be gained by deleting it from the second paragraph and retaining it in the first.

Mr. Swan reported that employment in the Pacific Coast States rose slightly in September, as a result of a small increase in nonagricultural employment and a considerably larger increase in agricultural employment. The behavior of the employment series had been somewhat erratic in the past several months; the September rise followed an August decline and a July increase. The unemployment rate had remained unchanged at 6.1 per cent. Employment in the construction industry had declined, however, and orders and prices in the lumber industry were said to be reflecting a slowdown in housing construction. One bright spot in the defense--and space-related area had been a scheduled increase of something over 10 per cent from fiscal 1964 to fiscal 1965 in the N.A.S.A. distribution of funds to prime contractors in the District. Of course, it remained to be seen what implications this would have for actual programs.

Mr. Swan said that recent gains in business loans at weekly reporting banks in the District had been somewhat smaller than a year ago, but the September quarterly interest rate survey reflected interest rates at banks somewhat higher than in the previous quarter and than a year ago. The new survey of lending practices indicated somewhat firmer lending policies by banks, although not uniformly nor in all measured characteristics. Borrowings from the San Francisco Bank were up in the two weeks ending October 7 but they dropped rather sharply in the week of October 14.

Mr. Swan observed that he had no particular disagreement with what had already been said on policy. It seemed to him that there had not been much change in the business situation during the last three weeks. The uncertainties that had been noted at the previous meeting still remained, and recent political and other developments abroad had created some new uncertainties. The deficit in the balance of payments, although still serious, now appeared to have been smaller in the third quarter than it was in the second, and the covered differentials between domestic and foreign short-term interest rates were somewhat more favorable to the U.S. now than they had been for some time. Also, the Treasury had a refunding operation ahead. For all of these reasons, Mr. Swan said, he would not favor a change in policy at this point.

In looking ahead, Mr. Swan continued, a factor relevant to the level of bill rates seemed worth commenting on. These rates typically came under rather substantial upward seasonal pressure between now and the end of the year. This was shown in a rough way by the fact that in 11 of the last 13 years--that is, in all years since 1950 except 1957 and 1960--the monthly average bill rate had been substantially higher in December than in October. It was true, of course, that free reserves were lower in December than in October in 7 of the 11 years, but they were higher in December in 4 years. He thought this seasonal pattern in bill rates had some implications for the pressures at the discount window and on the bill rate that the Committee might expect over the next few months.

Mr. Swan remarked that he would accept the first paragraph of the directive as drafted by the staff. He did not feel strongly about the reference to the auto industry settlements, but was agreeable to its elimination. On the assumption that no change in policy was to be made today, he would favor renewing the second paragraph of the directive without change.

Mr. Deming reported that conditions in the Ninth District generally were about the same as in the nation. However, because agriculture was so important in the District, a weak agricultural situation had more impact there than in the country as a whole. District banks also were showing less expansionary tendencies than were evident at the national level; patterns of change in District banking were about the same as last year.

Mr. Deming saw no reason to change the Committee's policy at the present time and, therefore, he would keep the second paragraph of the directive unchanged. He thought Mr. Ellis' point about potential inconsistencies within this paragraph had merit, but to eliminate the last phrase in the absence of a decision to change policy might create more problems in the long run than it would resolve. Mr. Deming favored deleting the phrase on the automobile industry settlements from the first paragraph. Otherwise he would accept the draft as submitted.

Mr. Scanlon reported that economic activity in the Seventh District continued to rise and the gap between output and "capacity" appeared to have narrowed further in most major industries. However, relatively few industries were operating at "capacity" and in those industries capacity was, of course, being increased. As he had reported at the previous meeting, firms in most industries indicated that they could handle additional orders in their present facilities.

Employment conditions in the District remained favorable, Mr. Scanlon said. Initial unemployment compensation claims declined in September, continuing a recent trend, and were at a low level. Most of the large Midwest firms reported that the local labor supply was adequate relative to their needs. Several steel firms, however, had indicated recently that they were unable to find sufficient workers in the immediate region and were forced to recruit production personnel from quite a distance.

Mr. Scanlon remarked that bankers in the major cattle-feeding areas in the District reported that loan demand was developing less rapidly than normal for this time of year because of the lower prices and smaller number of feeder cattle being purchased. This might be only a temporary situation. Farm real estate prices continued to move up and country bankers expected that trend to continue.

District banking figures showed a continuation of the rapid expansion of commercial and industrial loans that had been evident since early August, Mr. Scanlon continued. The net increase in business loans over the past six weeks was slightly less than in the same period last year, but a larger share was accounted for by manufacturers of metal products and other durable goods. These firms usually paid down bank loans in October and November. The large District banks had also reported sizable increases in other loan categories that tended to reflect increased credit demand from business and consumers. But their lending to securities dealers and finance companies had been reduced.

Mr. Scanlon said the quarterly survey of interest rates on commercial and industrial loans showed no significant change in interest rates. It did, however, indicate a sharp rise in the proportion of loans with maturities of more than one year. The increase was largely because of the larger size of those loans the number of term loans increased only slightly. The total amount of term loans reported was far greater than in any survey since June 1959.

The major District banks had not been under severe reserve pressure. Although borrowings at the discount window had risen, the total deficit position had not increased greatly and had been covered mainly by purchase of Federal funds.

It was Mr. Scanlon's opinion that deposit growth had been proceeding too rapidly with the money market conditions that had prevailed recently. It seemed clear that if the rate of increase in deposits was to be slowed, given present levels of credit demand, interest rates would have to be permitted to rise further. However, in view of the considerations that had been mentioned he questioned whether any action should be taken today insofar as monetary policy was concerned.

As to the directive, Mr. Scanlon said, he could accept the draft language for the first paragraph, but it seemed to him that somewhere down the line it was going to be difficult to reconcile the figures the Committee was seeing with the continued use of the phrases "moderate growth" and "moderate expansion" in the absence of a change of policy.

Mr. Clay said that economic activity in the Tenth District had been adversely affected this year by a decline in farm income. Drought conditions during the summer and lower prices for wheat and cattle were important factors reducing farm income below the 1963 level in the first two-thirds of the year. Accordingly, cash receipts from farm marketings averaged 6 per cent below comparable 1963 receipts.

Farm income in the District should make a better showing for the last third of the year, Mr. Clay observed. The principal factor should be increased cash receipts from larger farm marketings of wheat and cattle and improved meat animal prices. This favorable development would be limited somewhat, however, by a reduction in output from fall harvested crops by one-fourth below last year's levels because of the summer drought. A second factor increasing farm income in the latter part of the year would be the certificate payments under the 1964 Government wheat program. On balance, District farm income in the last third of the year should surpass the year-ago level, although it would remain significantly below late 1962 and early 1963 levels.

Nonfarm employment in the District continued to run counter to the rational trend, Mr. Clay continued While the nation had recorded substantial advances in nonfarm employment, the District had been marked by a modest, yet continuous, downtrend in seasonally adjusted nonfarm employment from the peak established in January this year. This decline was traceable to a decrease in construction employment dating from November 1963 and a drop-off in manufacturing employment beginning in February this year.

These developments were concentrated in three States, with nonfarm employment in the remainder of the District showing little change this year.

Nationally, Mr. Clay said, even though the third quarter increase in GNP was smaller than that in the second quarter, the advance in final purchases was one of the larger ones of this expansion period. On the basis of this information and other more current data, it was apparent that the response in personal consumption and in business capital investment to the combination of national economic policies was providing the basis for the continuation of over-all expansion. As an over-all appraisal, the factors to be considered in the formulation of monetary policy today were not perceptibly different from three weeks ago. All factors considered, it appeared appropriate to pursue the same monetary policy, with the same money market objectives, as was adopted by the Committee at that time.

Mr. Clay said the staff draft for the first paragraph of the economic policy directive appeared quite satisfactory to him preferably without the reference to the automobile industry labor settlement. The second paragraph of the current directive should be readopted in its present form, he thought. Mr. Clay did not favor a change in the Federal Reserve Bank discount rate.

Mr. Heflin reported that the generally healthy state of Fifth District business continued. The statistical picture remained strong, and most important industries again showed moderate growth. In August, the latest checkpoint, nonfarm employment reached a new high, and factory man-hours rose but remained slightly below the record level. Bank debits increased in September but not quite enough to match the July all-time high. In construction the current growth trend might be leveling out, however, as employment declined in August and contract awards dropped to the lowest level since February. Plans had been announced recently for the construction of several new textile plants to be more efficient and more highly automated than any now in operation. One textile leader expressed the opinion that, after 30 years of plant liquidation, the industry had now turned the corner and would be expanding capacity in the years immediately ahead.

Mr. Heflin observed that the Richmond Bank's latest survey showed more diversity of opinion regarding the general business outlook, and somewhat less optimism, than had appeared in several previous reports. Manufacturers, however, again indicated on balance further gains in new and unfilled orders, shipments, and employment. Few outside the textile industry reported higher prices or wages. Over the past six months of the Bank's survey, increases in prices received were reported on average by 11 per cent of the manufacturing respondents, and were matched by an equal number of reported declines. Reports of higher wages, however, had averaged 20 per cent of returns, with wage declines too scarce to be significant.

Mr. Mills commented that his statement would stick to facts as he saw them and would not attempt to theorize about future developments. He then made the following statement:

> A number of public statements emanating from both official and private quarters have expressed concern in varying degree about developing inflationary pressures. The rapid increase in the prices of nonferrous metals, the upward-cost trend in labor wage settlements, and the strength in consumer spending have all been cited as reasons why monetary and credit policy should shift more positively toward restraint than has been the case. Despite relatively easy reserve conditions, the money market apparently has taken the "open-mouth policy statements" to heart and, in consequence, short-term money rates have held firm and are predicted to move higher. These developments offer an opportunity for the Federal Reserve System to espouse by policy actions the currently publicly expressed sentiments regarding inflationary potentials. To do so would represent a refreshing and welcome return to free market principles, by virtue of which the interest rate structure becomes the product of the interaction of market forces rather than the creature of official policy decisions.
>
> There are those who still believe that the economy needs the stimulus of a relatively easy monetary and credit policy, particularly as a means to ward off the possibility that economic conditions will run down in 1965 and consequently should be bolstered up in advance of such a possibility in order to forestall a business recession. Contrariwise to this reasoning, a stimulative monetary and credit policy that was maintained into the future very likely would aggravate the inflationary

pressures that are becoming apparent and, in so doing, produce a situation that would require stern measures of credit restraint at some future date, with consequent damaging results to the economy. On balance, it is preferable to adopt a more restraining credit policy than that presently operative as a means of curtailing any further growth of inflationary pressures. Moreover, an effect of a slightly more restraining credit policy will be to discourage commercial bank lending abroad and in that way serve as a deterrent to the outward movement of dollars at the further expense of this country's adverse balance of payments. Although monetary policy should not be used as an instrument to influence bank lending and investment policies any more than bank examination procedures should be used to supplement official monetary policy, nevertheless, a less easy Federal Reserve System monetary and credit policy, by reducing the availability of credit, would oblige commercial banks to be more careful in their choice of loans and investments. In that indirect way, monetary and credit policy would exert a favorable by-product influence toward the betterment of commercial bank credit practices.

Mr. Mills added that, to reduce his thinking to concrete terms, he would accept Mr. Ellis' proposal to keep free reserves in the positive range from zero to $50 million.

Mr. Robertson said that in view of the fact that the domestic and international situations were unsettled this was clearly a time to avoid rocking the boat. He thought the Committee should continue the policy that had been adopted at the last few meetings and wait and see. As to the directive, he would accept the staff draft for the first paragraph, deleting the reference to settlements in the automobile industry, and he would make no change in the second paragraph.

Mr. Shepardson said that while he recognized that this probably was not an opportune time to make a significant policy change, he still was concerned about increasingly adverse pressures that would, it seemed to him, compel more significant action in the future.

Mr. Shepardson did not think the Committee ought to make the change in the second paragraph of the directive that Mr. Ellis had proposed. However, he was not sure whether the clause in this paragraph which read "with a view to maintaining about the same conditions in the money market" referred to the conditions actually prevailing or to the targets that had been intended. He thought the targets had been missed, and he hoped that if this clause was retained it would be interpreted as not applying to conditions that reflected inadvertent slippage.

Mr. Shepardson said he assumed the reason for omitting the phrase referring to the auto settlement from the first paragraph was that the settlement had not yet been completely attained. It seemed to him, however, that enough settlements already had been reached, particularly when one included the issues already agreed upon in the General Motors negotiations, to justify including the reference. He found the settlements that had been made so far to be disturbing.

Mr. Mitchell said he would vote for no change in policy, and he was agreeable to deleting the reference to the wage settlements from the first paragraph. He thought the point with respect to these settlements was whether they had set a pattern that other industries would find they could not afford without price increases. To his knowledge, no one had argued that the automobile industry itself could not afford them.

Mr. Mitchell remarked that there was a great deal in what Mr. Ellis had said about the potential inconsistency within the second paragraph of the directive. However, he doubted that the appropriate remedy was to be found in the change suggested. Accordingly, he would favor continuing this paragraph as it was.

Mr. Mitchell concluded with some observations on the chart presentation at this meeting, which, he thought, had been quite useful.

Mr. Daane said he would like to second Mr. Mitchell's appreciative remarks about the staff review. It seemed to him that what underlay all of the recent discussion about the directive was a desire for better analysis rather than for better words. He thought it was highly useful to look ahead at possible future developments, and later to compare these projections with actual developments, and he hoped that this kind of analysis might come out of the discussions on the format of the directive.

As far as policy was concerned, Mr. Daane said, it seemed perfectly clear to him that "even keel" was called for, not only because of the prospective Treasury refunding but also because of the uncertainties and unsettlements abroad and at home. Indeed, he would underscore the word "even." He thought the Committee should not rock the boat in any way and should give the market every possible indication that policy was not being changed. Therefore, he would not agree with Mr. Irons that occasional net borrowed reserves were no cause for concern; he would be concerned about anything that could be misconstrued as indicating a change in System policy. He thought the "tone and feel" of the market was a meaningful target for the Committee's operations and he would like to see the tone and feel kept as even as humanly possible. Mr. Daane concluded by saying that he was skeptical that the present uncertainties would fade by the time of the next meeting, but he thought there was little point in trying to forecast what the Committee might do at the next meeting or in coming months.

Mr. Hickman said that one of the important effects of the work stoppages in the auto industry was to obscure temporarily the question as to whether there was overexuberance in the economy. September production figures, as the Board's staff had noted, were adversely affected by developments in the automobile industry to the extent of four-tenths of one index point. Retail sales also presented a mixed picture partly as a result of the introduction of new cars, which boosted the late September figures and depressed early October results.

Monthly scores for business activity in October would be incomplete at the next meeting of the Committee, Mr. Hickman noted. Some of the figures would probably indicate a slight interruption of the upward movement of business. More importantly, the inevitable upward rebound would probably be registered in the figures for November, which would not become available until December. Thus, it might be mid-December before the Committee would have solid evidence as to what was really happening in the economy.

One of the factors the Committee should begin to think about, Mr. Hickman remarked, was the small but persistent rise in labor costs per unit of output in manufacturing that had occurred over the past four months. Since selling prices had remained steady, the implication was that profits had declined. If settlements in the automobile industry were not isolated within that industry and closely related industries prices must rise or profits must fall. If the latter should happen, there would be adverse effects on stock prices, business investment, and consumer spending.

Against this background of fragmentary economic information, current domestic and international political uncertainties, and a Treasury refunding to be announced later this month, Mr. Hickman said he could only recommend at this time that no substantive change be made in the second paragraph of the directive. The staff's rephrasing of the first paragraph was acceptable to him and he would prefer to include the reference to the wage settlements in the automobile industry. He hoped that the new program for reporting reserve positions by a sample of banks would result in tolerably accurate estimates of free reserves.

Mr. Hickman also pointed out that the latest data on monetary variables suggested that a bill rate of 3.60 per cent bid might not be consistent with a free reserve level of $50 million under present conditions of strong credit demand. In the latest week, for example, the bill rate had been very close to the Committee's target but the preliminary free reserve figure was $186 million. In view of the substantial increases in the money supply that had occurred in recent months, as well as in the first half of October, it might be desirable to think in terms of a seasonally adjusted bill rate of 3.60 per cent, which under present circumstances might imply an actual rate for 91-day Treasury bills of, say, 3.65 per cent. Such a pattern, Mr. Hickman believed, would be consistent with the Committee's current intent. He would seek to avoid a free reserve figure very far from the $50 million level, and he certainly would not want to see the figure fall below zero at the present time.

Mr. Bopp said that economic conditions continued to be good in the Third District. Unemployment claims remained well below the totals reached in any recent year, and labor market classifications in the District showed the best pattern since the inception of the present rating scheme in 1955. Help-wanted indicators for the Third District also had been moving upward for over a year.

Electric power consumption in the District's manufacturing industries continued to keep pace with the rise in the nation's manufacturing output, Mr. Bopp said, although construction contract awards, residential and nonresidential, had dipped below the totals reached in 1963 in both the Third District and the nation. Department store sales in the District exceeded 1963 levels by 8 per cent for the year to date. This came closer than usual to the national performance; the comparable national figure was now between 10 and 11 per cent.

Total loans and investments (adjusted) at weekly reporting member banks dropped between September 16 and October 14, Mr. Bopp continued. Business loans were off slightly, as were investments. Both these decreases were, however, in line with the District's experience last year during approximately the same time period. On a cumulative basis for the year, total loans and investments were well above last year. The deficit in the basic reserve position of reserve city banks declined slightly for the three weeks ending October 14. Borrowing by reserve city banks also declined slightly on an average daily basis, and country bank borrowing was still light.

It seemed to Mr. Bopp that there were four major developments to watch in evaluating the present and prospective business environment: prices, unemployment, bank credit, and the balance of payments. Although price pressures had been evident in some areas--especially in nonferrous metals and in some steel products--the over-all wholesale index remained little changed. It was possible, of course, that prices might soon begin to rise at a faster pace if businessmen started accumulating inventories more rapidly and production ran into more bottlenecks. So far as Mr. Bopp could tell, however, inventory policies were still quite conservative and any pickup in accumulation started from a very favorable position. As far as bottlenecks were concerned, his analysis suggested that the likelihood was not strong that the economy soon would be pressing hard against capacity. This was because additions to capacity seemed likely to proceed at least as fast as additions to output.

Meanwhile, unemployment had shown little change and continued uncomfortably high. Bank credit had been increasing at a rapid pace and would bear watching. A survey of the District's larger banks suggested, however, that little beyond a normal upswing would develop in loan demand during the next three to six months.

On the international front, it seemed too early to Mr. Bopp to take any action on the basis of early October figures for the balance of payments. He continued to be encouraged, however, by the narrowing of the third quarter deficit relative to that which occurred in the second quarter.

On balance, Mr. Bopp felt that the present degree of ease continued to be appropriate to domestic business and to the balance of payments. The staff draft for the first paragraph of the directive, omitting the reference to the auto settlements, seemed appropriate. He was sympathetic with Mr. Ellis' suggestion for the second paragraph but if no change in policy was to be made he would let this paragraph stand as it was. He did not favor a change in the discount rate.

Mr. Patterson reported that little or no evidence of a slowdown in the rate of economic expansion had developed in the Sixth District. The District continued to show slightly, but not spectacularly, greater advances than the nation generally, according to comparable available statistics. For the area as a whole, there was a slight loss in manufacturing employment in August, most of which took place in Georgia when the auto model changeovers brought temporary layoffs at the Ford and General Motors assembly plants.

Potentially, Mr. Patterson commented, the chief weakness in the District seemed to lie in construction. Contracts were drifting downward month by month although current projects were supporting a stable level of employment. Most of the downward drift in contracts was explained by a drop in nonresidential, nonbuilding contracts.

Any judgment of the degree of consumer acceptance of the new model cars was complicated by the short supplies of the General Motors dealers. American Motors and Ford dealers, according to the results of a spot survey made in Atlanta by the Bank's Research Department, were selling approximately 15 to 20 per cent more cars than at a comparable date last year. Plymouth dealers complained that they could not get delivery on enough cars to meet current demands, and General Motors dealers feared a permanent loss of sales to competitors. They reported, however, that potential customer response in their showrooms had been quite good. Other types of consumer buying were apparently holding up well.

Mr. Patterson remarked that nature's behavior had been far more spectacular than the behavior of the economic indicators. So far this year, various parts of the Sixth District had been struck by four hurricanes. Hilda, the third largest hurricane to drive into Sixth District territory this fall, swept across southern Louisiana on October 3 and 4, blowing down most of the sugar cane crop and damaging the cotton crop. Early estimates, implying a halving of the $80 million cane crop, had been revised sharply upward as harvesting activity gained headway. A recent telephone survey of the major lenders financing Louisiana cane growers showed that most growers would be able to repay their operating and mortgage debts and those who could not would be carried by the creditors. A fourth hurricane, Isbell, blew across the southern tip of Florida on October 14, causing some damage to vegetable crops, although the amount of damage was not yet known. Elsewhere in the District, weather had been favorable to crops, and harvesting continued apace.

Mr. Patterson said the only tightening of credit that could be detected from District banking figures was a failure of holdings of Government securities to rise as much this September as in the comparable months of past years. During September member banks on an average were in a net sales position in respect to Federal funds. During the first three weeks of September they were in a free reserve position, but in the final week of the month their borrowings exceeded their excess reserves for the first time since the week ended August 12, and they were in a net Federal funds purchase position. Apparently, their reserve positions eased in early October, however. Loans continued to expand.

Mr. Shuford reported that economic activity in the Eighth District, which had begun to pick up in early summer, continued to rise during September. From August to September manufacturing output rose substantially and the limited available data on payrolls in the major labor markets indicated that there also had been a gain in employment. At weekly reporting banks, business loans and deposits had been increasing at rapid rates since August.

Mr. Shuford favored no change in policy for the various reasons already mentioned. At the same time, he shared the concern some had expressed about recent rates of growth in reserves, money, and bank credit. Since May, the annual rate of expansion in bank reserves and money supply had been about 6 per cent, which, he thought, was greater than was sustainable over an extended period without increasing inflationary pressures, given the strength of the economy. The Committee was certainly going to have to deal with this situation, and perhaps take steps to bring these growth rates--which he, like others, did not regard as "moderate"--more into line with the wording of the directive.

Mr. Shuford said the staff draft of the first paragraph of the directive was satisfactory to him, with or without the reference to the automobile settlements. He leaned slightly toward including this reference, but did not consider the question of great importance. He recognized that the last clause of the second paragraph was potentially inconsistent with the first, but since the Committee apparently would make no change in policy today, he would leave the second paragraph as it was. Mr. Shuford favored no change in the discount rate.

Mr. Balderston commented that it was clear that the Committee did not want to make a formal change in policy during the next three weeks. However, he would like to call to the Committee's attention a matter that gave him great concern--the possibility that the Committee might be abdicating its main responsibility, to preserve the stability of the dollar. Against the background of recent growth rates for GNP and industrial production--5.2 and 6 per cent, respectively, over the last 12 months--the figures for growth in money supply and total bank reserves from June to date gave cause for real concern as to whether the Committee had permitted its policy to get off track for an entire third of a year.

Even though the Committee might not change its general policy for the three weeks ahead, Mr. Balderston said, he would like to suggest again that it set its target in the zero to

$50 million range for free reserves as Mr. Mills had suggested, and that it should not be fearful of a drop in free reserves below the zero level, as Mr. Irons had suggested. The fear of net borrowed reserves, Mr. Balderston believed, could cause the Committee to fail to do its duty. He did not think that the health of the bond market should be put above the Committee's duty; the state of the bond market was the Treasury's responsibility. For weeks now, fear of seeing free reserves penetrate the zero line had prevented accomplishment of the objective the Committee had intended in its August decision.

Chairman Martin asked whether Mr. Balderston was being critical of the Manager. Mr. Balderston replied that he was not; in his judgment the Manager had followed Committee instructions with respect to free reserves. Mr. Balderston thought the fault lay with the Committee.

The Chairman then invited Mr. Stone to comment on any problems he had encountered in operating under the instructions issued at recent meetings.

Mr. Stone said he had felt that the Committee preferred to avoid the emergence of a net borrowed reserve figure for a week, and particularly for two successive weeks. When figures behaved as erratically as the reserve figures did, he thought the objective of avoiding negative free reserves induced a bias in operations toward higher figures--a bias that was inescapable, although he tried to keep it as small as possible. If the Desk came into a Wednesday with a projection of, say, $10 million free reserves for the statement week, the likelihood was good that the week's figure finally would turn out to be negative. Therefore, he usually tried to come into Wednesday with a free reserve figure reasonably close to the $50 million mark, or perhaps even above $50 million if the tone and feel of the market suggested that the estimate was too high.

In response to a question by Mr. Robertson, Mr. Stone said he had considerable confidence in the ability of the bond market to adjust to net borrowed reserves, although the publication of such a figure would stimulate a good deal of discussion in the market. Mr. Robertson then asked if the Desk had taken any action designed specifically to protect the "health of the bond market," and Mr. Stone replied that the Desk's operations were not addressed to protection of the bond market at all.

Mr. Hayes remarked that he thought one factor underlying the reluctance of some members to having negative reserve figures eventuate had been the possibility that such figures would upset the bond market.

Mr. Daane commented that as one who had favored avoiding negative free reserves he could say his reasons were not based solely on a concern for the bond market. If the Treasury was engaged in a major financing at a time when the market was in an uncertain condition, any development that changed expectations was likely to have a considerably greater effect than he thought the Committee would want to see for either domestic or international reasons. What he had been saying this morning was that at this juncture, with the unsettlements in the international picture and with the market looking to the System for clues as to its policy posture, it would be unwise, in his judgment, to do anything that might suggest modification of System policy. It was for this reason that he wanted to avoid negative free reserve figures at present.

Mr. Hayes said it seemed to him that the Committee had created its own problem to some extent, by operating for so long with excessive concern over the possible appearance of negative figures. He agreed with Mr. Balderston that it would be desirable to get away from this situation. At present, however, the Committee was confronted with the fact that the market would put a rather serious interpretation on negative free reserves and he was not advocating a change now in view of the Treasury refunding.

Mr. Hickman said he shared this view. He thought net borrowed reserves would be undesirable now, in view of the re-funding and of the various uncertainties that existed. After the refunding, however, if the Committee felt confident about the economic outlook, he might well favor a net borrowed reserve target.

Chairman Martin said he thought the Committee's position right along had been that it did not favor negative free reserves but that it would not be critical of the Manager if they occurred inadvertently. Mr. Stone had spoken honestly when he indicated that the effort to avoid a negative figure led to some, perhaps subconscious, upward bias in his operations. It was true that there had been a rather large miss on the upside in the most recent statement week. But there was a problem at present in operating under an instruction to maintain the "same conditions in the money market." He doubted whether the Committee could cut matters as finely as it had tried to do in recent discussions of free reserve targets. The Manager had been given a difficult assignment, and in the Chairman's judgment he had done an excellent job in trying to meet the wishes of all members. The Chairman agreed that the fault lay with the Committee, it had created the problem itself.

Mr. Shuford commented that he shared Mr. Balderston's view on the matter of negative free reserves, and he also agreed that the Committee had got itself into this situation. He had participated in the daily telephone conference for the past three weeks, and did not recall any specific mention of the problem of avoiding negative figures; it had been his feeling that the Desk was operating in terms of the tone and feel of the market. There were disturbing gyrations in the numbers, particularly over the Columbus Day holiday, but Mr. Stone had explained that this was an annual problem, and that one almost had to ignore the figures for that week. Mr. Stone had spoken candidly today in indicating that he had been leaning against having negative free reserves eventuate. Mr. Shuford thought he was justified in doing so in view of the discussion at the last three Committee meetings; the Manager had been following the instructions given him.

Mr. Stone commented that the past week had to be considered an aberration. Float had soared over the holiday weekend and, as of Wednesday, it would have required sales of about $1 billion to bring weekly average free reserves down to $50 million. He was sure that no member of the Committee would have wanted the Desk to make such sales. In the preceding week, however, on Tuesday morning free reserves were estimated at barely above zero. Because the market was acting in such a way as to cause him to believe that the estimates were wrong, he had been prepared to take the risk of skirting zero quite closely.

Mr. Bopp noted that the Manager had reported in his memorandum to the Committee dated October 16 that in 15 of the first 38 weeks of 1964--or in roughly 40 per cent of the weeks--the first published free reserve figure differed from the final figure by $40 million or more, and in 9 weeks the differences were at least $60 million. Thus, revisions often were of the same order of magnitude as the margin for error allowed the Manager. (A copy of the memorandum referred to by Mr. Kopp has been placed in the files of the Committee.)

Mr. Swan said it seemed to him that it was legitimate for anyone to be critical of the Committee for the policy decisions it made. However, he did not think it was legitimate to criticize the Manager for not having carried out the policy change decided on at the August 18 meeting. The emphasis then had been on accomplishing an extremely mild and gentle change, and it seemed to Mr. Swan that the Manager had tried to do exactly that.

Mr. Irons commented that in his earlier remarks he had not meant to imply that he favored a deliberate attempt to produce negative free reserves. The Committee had been narrowing its target range steadily, and had now gotten it down to a point where the Manager could hardly avoid a mistake. With a target of $50 million and an instruction not to go below zero, the Manager was given very little margin for error on the downside, although he did have some on the upside. This kind of instruction was unfair to the Manager, and the Committee had to expect that a negative figure would result some time. In his judgment free reserves were not good figures to use for targets in any case; and the Committee was attempting to play them too finely. He was not advocating negative free reserves, but he thought the Committee was putting the Manager in an impossible situation with the type of instructions it had been giving him.

Mr. Daane said that he had consistently thought it unwise to try to narrow the margin in instructing the Manager, and his own disposition would be to give him wider latitude than, say, a zero to $50 million range. However, it was still true that a negative free reserve figure now probably would be construed as a change in System policy, and in his judgment this was something the Committee could not afford in the present conjuncture of domestic and international affairs. In a way, he felt just as frustrated by the situation as Mr. Balderston evidently did, but he believed negative free reserves should be avoided if the Committee did not want to signal a change in policy.

Chairman Martin said the Committee had wanted to make a gradual change in policy, with the emphasis on "gradual," and that was what had caused the difficulty. The change made had in fact been quite gradual, and eventually it had been almost obliterated.

The Chairman continued by observing that there seemed to be little difference in views on policy at this meeting. With respect to the directive, a majority seemed to prefer omitting the bracketed reference to the settlements in the automobile industry from the first paragraph, and a majority appeared to favor making no change in the second paragraph, despite the feeling by some that Mr. Ellis' comments on this paragraph were valid.

Mr. Hayes noted that Mr. Brill, in commenting on the outlook, had said the greatest threats to stability lay in excessive wage increases and accelerated inventory accumulation. If the Committee was concerned about these threats he thought it should give some recognition to that fact. One possible way of doing so was to include a phrase such as the following in the list of factors which the Committee's policy was said to take into account: ". . .the relative stability in broad commodity price averages that continues to obtain despite recent developments affecting prices, wages, and inventory policies that could, if they spread, disturb that stability." In his judgment the staff's draft did not accurately reflect the Committee's concern with existing threats to price stability.

Mr. Mitchell said he would reiterate that he would be concerned about wage settlements only if it became clear that the auto industry settlement had become a pattern for other industries. In his opinion it would be appropriate then to refer to wage settlements in the directive, but it was not appropriate at present.

Mr. Hayes replied that since the auto industry announcements there had been a change in the whole character of comments on the price outlook made at Committee meetings. While there was no certainty that they would set a pattern for other industries, the terms of the auto wage contracts had stimulated a great deal of concern.

Mr. Daane said that if the directive was to include references to all significant factors of concern to the Committee, there were a great many political and economic uncertainties around the world that should be mentioned. There also was a Treasury financing in the offing. The consensus today, he thought, was for an even keel policy against the background of the financing and of these other factors.

Mr. Hayes commented that it was customary to include some reference to Treasury financing operations in the second paragraph, and he thought this should be done in the directive to be adopted today.

Chairman Martin suggested that the Committee vote on the draft directive as prepared by the staff, except for deletion of the bracketed reference to the settlements in the automobile industry from the first paragraph and addition, after the word "policy" in the second paragraph, of the phrase "and taking into account the forthcoming Treasury financing."

Thereupon, upon motion duly made and seconded, and by unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the 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 the reserve base, bank credit, and the money supply for the purpose of facilitating continued expansion of the economy, while fostering improvement in the capital account of U.S. international payments, and seeking to avoid the emergence of inflationary pressures. This policy takes into account the further expansion in economic activity, tempered by a work stoppage at a major automobile company; relative stability in broad commodity price averages, even though additional price increases have occurred in some materials markets; and indications that the vigorous money supply expansion of recent months continued in the first half of October. It also gives consideration to current estimates that the deficit in the U.S. balance of payments in the third quarter continued at a high rate, although not quite as high as in the preceding quarter.

To implement this policy, and taking into account the forthcoming Treasury financing, System open market operations shall be conducted with a view to maintaining about the same conditions in the money market as have prevailed in recent weeks, while accommodating moderate expansion in aggregate bank reserves.

It was agreed the next meeting of the Committee would be held on Tuesday, November 10, 1964, at 9:30 a.m.

Chairman Martin then noted that the Committee had discussed the directive proposals of Messrs. Ellis, Mitchell, and Swan at the meetings of July 28 and September 29. It had been contemplated that the discussion would be continued at this meeting, and the group working on the proposals had prepared a four-part outline for the discussion. Also, Mr. Hayes had circulated a memorandum entitled "The Ellis-Mitchell-Swan Proposal Revisited" under date of October 15, 1964. (A copy of this memorandum has been placed in the files of the Committee.)

The Chairman said that he had studied this matter quite actively over the weekend. He had been impressed with Mr. Hayes' memorandum, which gave a clear statement of the negative case on the proposals. However, the memorandum did not make a positive contribution to the solution of a problem with which the Committee had been concerned for a long time. Perhaps there was no acceptable solution.

It was possible, the Chairman observed, that most members felt they could live with the present directive insofar as internal operations of the Committee were concerned. However, the directive also was a public document, and there had been many criticisms to the effect that the information the System disseminated on its policy actions was poor. In his opinion the Committee had a long way to go if it was to develop a directive that would exp[illegible] in its actions and objectives adequately.

The Chairman felt that the Committee could debate the various aspects of the directive for a long time. However, he said, perhaps the best way of coming to grips with the question of whether it could improve the directive, and of bringing the Committee's best thinking to bear on the subject, was to experiment. Accordingly, he proposed that the staff be asked to continue to draw up drafts of directives that might have been issued if the new format actually was being used, and that Committee members engage in informal trial deliberations on these directives after adjournment of the meetings, to see whether it was possible to get majority agreement on language. They might begin by planning to devote the afternoon to this purpose on the day of the next meeting, November 10. It could be learned by this means whether a new approach was feasible, or whether the task was hopeless and the present directive format should be retained.

Such a trial program obviously would be quite a burden on everyone involved, the Chairman observed, but it would be a good way to get a clear basis for a decision. To put the question of a new directive format to a vote without such experimentation would, in his judgment, be a mistake. Hopefully, by the time of the Committee's organization meeting in March 1965 enough experience would have been gained through such trial deliberations for the Committee to reach a decision on the format of the directive.

In the past, Chairman Martin said, he had been a proponent of the thesis that it was best to retain the present short form of the directive because that was the simpler course. But he now felt that the Committee had an obligation not to follow this course unless it had convinced itself that it could not do better.

Mr. Hayes said that the difficulties that the Committee had experienced at this meeting and the previous one in trying to get agreement on language concerning a single substantive issue demonstrated to him that it would be a serious mistake to attempt to reach agreement on a long, detailed text. It was mainly for this reason that he opposed the suggested elements 1 and 2 in the proposed new format; he thought the Committee would simply bog down in debate on language. One of the advantages of the present directive format was that there was a reasonable chance that the Committee would be able to reach agreement.

Mr. Daane commented that the Chairman's proposal, as he understood it, was simply to try to reach such agreement on language in the new type of directive. If Mr. Hayes was right that the Committee would bog down in discussion--and he (Mr. Daane) suspected that he was--this would be learned in the course of the trials.

Chairman Martin said he hoped everyone would approach this trial with an open mind. He thought the Committee should try to develop a better statement on how it assessed the economic situation in arriving at its policy decision at each meeting, whether it was done in the directive or in the policy record.

Mr. Hayes said he felt the "green book" would serve this purpose. There had been several suggestions that this book be made available to the public, and he thought such a procedure, which would not involve any change in the directive, was worth exploring.

Mr. Swan commented that while he thought the green book was an excellent compendium, in his judgment it did not substitute for a Committee assessment of the economic situation incorporated in the directive or in the policy record.

Mr. Deming asked whether it would be possible to have the staff drafts of the "trial" directives delivered by the Friday preceding each meeting instead of late on Monday, as had been the practice so far. Mr. Brill said that an entire week's data on banking developments would be missed if the staff tried to get the drafts to Committee members by Friday. It might be possible, however, to mail or telegraph the drafts to the Reserve Banks during the weekend before the meeting.

It was agreed that the Chairman's suggestion for experimenting with the new directive format would be followed.

Mr. Robertson said he had prepared a statement on the directive proposals that he would distribute to the Committee and staff after the meeting. (A copy of this statement has been placed in the files of the Committee.)

Thereupon the meeting adjourned.

Ralph A. Young

Secretary