A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, November 10, 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. Wayne

Messrs. Ellis, Bryan, 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
Messrs. Brill, Grove, Holland, Koch, Mann, and Ratchford, Associate Economists
Mr. Stone, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Cardon, Legislative Counsel, Board of Governors
Messrs. Williams and Partee, Advisers, Division of Research and Statistics, Board of Governors
Mr. Reynolds, Associate Adviser, Division of International Finance, Board of Governors
Miss Eaton, General Assistant, Office of the Secretary, Board of Governors

Messrs. Holmes, Sanford, Eastburn, Baughman, Tow, and Green, Vice Presidents of the Federal Reserve Banks of New York, New York, Philadelphia, Chicago, Kansas City, and Dallas, respectively
Messrs. Sternlight, Brandt, and Bowsher, Assistant Vice Presidents of the Federal Reserve Banks of New York, Atlanta, and St. Louis, respectively
Mr. Arena, Financial Economist, Federal Reserve Bank of Boston
Mr. Kareken, Consultant, Federal Reserve Bank of Minneapolis

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on October 20, 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 operations and on Open Market Account and Treasury operations in foreign currencies for the period October 20 through November 4, 1964, and a supplemental report for the period November 5 through 9, 1964. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Sanford said that the weekly published gold stock figure had remained unchanged again during the past three weeks. The Stabilization Fund's holdings, however, were down considerably since the last meeting, by $60.6 million, to $132.9 million. Prospective sales later this month would reduce the Fund's holdings to some $50 million by month end, and the Spaniards were looking for a considerable amount of gold over a period of several months. The London gold pool had lost another $6 million as demand continued to outstrip sales of newly-produced gold. The Russians had remained out of the market.

In the exchange markets, Mr. Sanford reported, heavy selling waves had buffeted sterling on two separate occasions, and had put heavy pressure on British reserves, which for October as a whole declined $86.8 million in spite of net drawings of $215 million by the Bank of England under facilities with the System and other central banks. At the end of October, the Bank of England's indebtedness to the Federal Reserve was only $5 million and to other central banks $410 million; for value today the Bank of England was drawing $75 million on the Federal Reserve swap, raising the total outstanding to $80 million.

The first heavy selling wave occurred on Friday, October 23, when the market learned that the British Government would, after that week end, disclose measures to deal with Britain's payment difficulties, and consequently sought to protect itself against all possible contingencies. The Bank of England was forced to intervene on a scale unprecedented since January 1963 when Britain's bid for Common Market membership was vetoed--a total of $82 million was expended to hold the rate at $2.7825. Sterling moved above $2.7850 for a few days following announcement of the government's measures, essentially because of covering operations. Thereafter, it traded at rates somewhat below this level without any sizable intervention until last Friday, November 6, when rumors of a possible devaluation of sterling hit an already apprehensive market and the Bank of England again had to step into the market heavily, selling $73 million. Thus, a deep-seated uneasiness continued to surround the pound which Mr. Sanford suspected would persist for some time, until there was convincing evidence of a turn-around in Britain's payments position. One important element in this regard was the attitude and reactions of the Continental countries concerning Britain's 15 per cent surcharge on imports of semi- and finished-manufactured goods. In the meantime, continued resort could be expected by Britain to short-term credit facilities with the central banks. The latter would, he understood, still make funds available to the Bank of England despite a considerable amount of complaining on the Continent concerning the U. K. import surcharge.

With respect to other markets, Mr. Sanford noted that there continued to be considerable flows of funds to the Netherlands and Belgium. The U.S. Treasury had had to absorb part of the reserve gains of those two countries by way of gold sales--$10 million to Belgium on October 19, $20 million to the Netherlands recently, and $30 million to Belgium for value on November 12--since the swap facility with the Dutch was fully used and the Belgian one largely so. Also, flows of funds into Swiss francs on Friday, November 6, possibly in connection with that day's rumors of sterling devaluation, prompted the New York Bank for the first time since June to sell $1.9 million equivalent of Swiss francs at its ceiling in the New York market within the Swiss National Bank's daily limit of 10 million Swiss francs.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System open market transactions in foreign currencies during the period October 20 through November 9, 1964, were approved, ratified, and confirmed.

At Chairman Martin's request, Mr. Young commented on the discussions concerning the British situation which had taken place at meetings in Paris from which he had recently returned of the Economic Policy Committee and of Working Party 3 of the Organization for Economic Cooperation and Development. Mr. Daane added a few comments on the discussions at the subsequent meeting of the Group of 10, which he had attended.

Chairman Martin then asked whether Mr. Sanford had any recommendations to present to the Committee.

Mr. Sanford replied that he had two matters to discuss. First, on December 9, a $30 million equivalent drawing of Dutch guilders from the Netherlands Bank would mature. Inasmuch as it was expected that tight money market conditions would generally prevail in the Netherlands at least until the year end and that the Dutch guilder would continue to be firm, Mr. Sanford proposed to renew the drawing for another three months. This would be the first renewal of this drawing, he observed.

> Renewal of the drawing on the swap arrangement with the Netherlands Bank was noted without objection.

Mr. Sanford then noted that a memorandum had been sent to members of the Federal Open Market Committee on November 5, 1964, concerning the proposed agreement between Federal Reserve Bank of New York and the Swiss National Bank which would implement, in so far as the United States was concerned, Switzerland's association with the International Monetary Fund's General Arrangements to Borrow. (A copy of this memorandum, entitled "Proposed agreement between the Federal Reserve and the Swiss National Bank to implement Switzerland's association with the International Monetary Fund's General Arrangements to Borrow," together with attachments, has been placed in the files of the Committee.)

There was little he could add to the explanations given in the memorandum, Mr. Sanford remarked, except to say that entering into the agreement would not adversely affect the availability of reciprocal short-term swap arrangements between the Federal Reserve on the one hand, and the Swiss National Bank and the Bank for International Settlements on the other, amounting to $300 million; that if medium-term accommodation was extended to the United States it was not expected that it would be through the Federal Reserve Bank of New York except as fiscal agent of the U.S.; and that if the Swiss should need medium-term assistance from the United States, this, too, would be taken care of by the U.S. Government and not by the Federal Reserve. Finally, in any event, no action affecting the Federal Reserve could be taken without specific authorization of the Federal Open Market Committee. He requested the Committee's authorization for the Federal Reserve Bank of New York to sign the agreement, noting that this matter had been under discussion for more than two years.

Mr. Young reported that he had received two suggestions for changes in the draft of agreement. The first was to add the phrase "acting pursuant to authorization and regulation of the Federal Open Market Committee" after "Federal Reserve Bank of New York" in the first sentence of the draft. The second suggestion related to the last sentence of Section 4, and involved substituting the word "consider" for the word "take" in this sentence, which read, "The Federal Reserve Bank of New York is prepared to take, in agreement with the Swiss National Bank, any other measures for assistance that may be thought appropriate."

In the discussion of these proposals some members indicated that they did not feel the suggested changes had any important substantive implications. They noted that, as Mr. Sanford's memorandum pointed out, any arrangements entered into under the agreement by the Federal Reserve Bank of New York in its own name would be subject to specific prior authorization by the Committee, and that the agreement did not impose a commitment on the United States to provide assistance to Switzerland but was intended only to express the readiness of the U.S. to consider such assistance. In view of these considerations, and of the possibility that any proposal to amend the agreement might further extend negotiations which had already been in process for over two years, they favored approving the draft in its present form. Other members expressed a preference for making the suggested revisions, particularly the first of the two, if it did not involve undue delay. After the discussion, the Chairman proposed that the Committee vote on the agreement with the understanding that the Committee's General Counsel would be authorized to decide whether either of the suggested changes should be proposed to the Swiss National Bank.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the agreement with the Swiss National Bank was approved, subject to the understanding described by the Chairman.

Note: Subsequent to this meeting the Committee's General Counsel decided that the suggested changes were not essential and therefore need not be proposed to the Swiss National Bank.

Mr. Sanford observed that he understood the Committee's Secretariat proposed, after the agreement had been signed by both parties, that copies of the press release dealing with the subject be sent to the relevant Congressional Committees, for their information. No objection was made to this proposal.

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 October 20 through November 4, 1964, and a supplemental report for the period November 5 through 9, 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:

> In the past three weeks the money market largely regained the firmer tone that had developed in August and September and that had temporarily given way to some occasional ease in late September and early October. Federal funds traded mainly at 3-1/2 per cent on all but one day of the last three weeks, and on most days there was some trading at 3-5/8 per cent. On occasion, the money market seemed on the verge of easing, and buyers of Federal funds tended to hold back, apparently in anticipation of lower rates, but the expected flows did not develop and the market tightened again.
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> System operations were substantial during the period. Reserve needs were generated not only by the usual month-end drains from market factors--compounded in this case because float had scaled unusual heights in mid-October and then fell back abruptly--but also by the absorption of reserves through transactions relating to the British repayment of $255 million of its swap drawing with the System on October 30. On a net basis, the System added $1,250 million to its holdings of U.S. Government securities and acceptances over the period--and this in addition to the release of around $300 million of reserves through a

reduction in the Treasury's balance with the Reserve Banks, as we discussed at the last meeting.

Notwithstanding the generally firm money market conditions, the securities markets strengthened during the period, as a number of market participants veered away from the view that a near-term rise in interest rates will occur. In terms of day-to-day market developments, the factor most responsible for turning the tide seemed to be the absence of an immediate British Bank rate increase with the advent of a new government in that country. At the same time, market observers noted that the automobile strike was slowing the economy's momentum, while the President's comments on the undesirability of a steel price rise were regarded as reducing the imminence of an inflationary outbreak. Equally important, these market viewpoints emerged against a background of substantially reduced dealer positions in Government securities, relatively light calendars of corporate and tax-exempt issues, and some accumulated demand from potential investors who had been waiting on the sidelines for a rise in yields that did not materialize. Prices of most longer-term Treasury issues rose half a point or more over the period, and three bonds were up by a full point.

In this setting the market gave a very good reception to the Treasury's cash offering of about $9-1/4 billion new 18-month notes which will be used to repay the November 15 maturities and raise some new cash. The new 4 per cent notes were oversubscribed to an even greater extent than expected in the market, and the percentage allotment was accordingly a little smaller than anticipated. The new notes began trading at a small premium, and demand has continued good. The largest single group of subscriptions is from commercial banks, and the behavior of banks in either holding the notes, selling them out, or liquidating some other assets to pay for them next Monday, may provide some measure of the degree of pressure under which the banks are currently operating.

The Treasury bill market also was the beneficiary of increased investor and dealer confidence, and the rate impact of these psychological effects was reinforced by the heavy System purchases of bills in recent weeks. The result was that rates moved slightly lower during much of the period. In the bill auction on November 2, average issuing rates of 3.56 and 3.72 per cent were set for the three- and six-month issues, respectively, compared with

3.59 and 3.74 per cent just before the last Committee meeting. Bill rates have edged slightly higher again in the last few days, however, and auction rates yesterday were about 3.57 and 3.74 per cent for the three- and six-month maturities.

The prospect of additional supplies from the Treasury remains a background factor in the bill market. Current plans call for the Treasury to announce, probably today, the sale of about $1.5 billion June tax bills, on which the Treasury is likely to allow 50 per cent tax and loan credit. After this the decks would be clear through the end of the year except for routine bill roll-overs. Shortly after that, the Treasury will presumably have to raise some additional cash, and if market conditions are favorable an advance refunding early in the new year is a distinct possibility.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period October 20 through November 9, 1964, were approved, ratified, and confirmed.

Mr. Stone then noted that in his memorandum to the Committee dated November 4, 1964, entitled "Bankers' Acceptances," he had recommended that the limit on the Account's outright holdings of these acceptances be raised to $125 million or 10 per cent of outstandings from the figures of $75 million or 10 per cent of outstandings now specified in the Committee's continuing authority directive. As the memorandum indicated, when the present limit of $75 million was established in 1958 the bankers' acceptances market was substantially smaller than at present. Total outstandings had more than doubled since then, and the average size of dealer portfolios had increased to over $200 million. Because the market had developed substantially, the Account Management believed that the proposed increase in the limit would help the Committee to continue to make as effective a contribution to the market as it had in the past. As the memorandum also indicated, the Desk had attempted to operate in this market in only a marginal way with respect to the volume of outstandings and of transactions. The Account Management would not regard the proposed new limit as target to be reached; the purpose was simply to provide additional leeway for operations if market conditions indicated their desirability.

Mr. Mills commented that he agreed the market for bankers' acceptances had grown substantially, but he wondered whether the Committee's operations had encouraged greater dependence on the facilities of the Desk than was justified, with the result that the market itself was not putting out enough effort to place acceptances.

Mr. Stone said he thought the market had developed a high degree of self-reliance. A few years ago the market was so small and insubstantial that dealers were not willing to hold more than \$15 or \$20 million in acceptances. Now, however, their holdings were in the neighborhood of \$200 million. A wide range of customers, both bank and nonbank, had been developed, and dealers maintained large portfolios in order to service these customers.

Mr. Mills then asked whether the acceptance dealers were now building up their portfolios possibly with the knowledge that they had recourse to the Federal Reserve if necessary.

Mr. Stone replied in the negative. He thought the dealers were now enlarging their portfolios because the aggregate volume of acceptances was increasing. Whenever the supply of acceptances was greater than the demand and dealers expected the situation to reverse, they tended to increase their inventories in the expectation of making a profit on resale in the market; they did not act in anticipation of purchases by the Desk.

Mr. Mills commented that the present size of dealer portfolios suggested that there was not an avid interest in acquiring acceptances in the market. Historically, acceptances had been a highly desirable and liquid market instrument. Mr. Stone had explained in his memorandum that the dealers were now adjusting their own positions. He would not deny this, but he wondered if the Committee was watching the situation closely enough to be sure that it was not simply providing a cushion for the benefit of dealers rather than helping the market. Mr. Stone observed that he was quite sure this was not the case.

Mr. Robertson said he felt somewhat as Mr. Mills did. He would not oppose the recommendation to increase the limit because it amounted simply to an updating of a decision the Committee had made 6 years ago after extended debate. He would say, however, that he saw nothing in Mr. Stone's memorandum to indicate whether the market was now standing on its own feet, or ever would. Nor was there anything in the memorandum to indicate whether the Committee had been weakening or strengthening the market, or how long the Committee would have to continue to support it. He hoped the objective was not to keep the Committee in a position to control the market.

Mr. Stone said that the Committee's purpose in re-entering the acceptance market in 1955, as he understood it, had been to encourage its growth and development without dominating it. In his judgment, operations had been successful in contributing to this end; the market obviously had grown quantitatively and qualitatively. Originally it was mainly a bank market, and it had been helpful to dealers in encouraging participation by nonbanks to be able to point to System interest in the market and System participation in a marginal way. Moreover, Mr. Stone said, System operations in acceptances had provided an opportunity to follow closely developments that were of interest from a regulatory point of view.

Mr. Mitchell said that he felt much as Mr. Robertson did. It was his understanding that the Committee originally undertook to aid this market with the presumption that aid would be given only until it was well established. Mr. Stone had reported that the market now was well developed, and the question arose as to why the Committee should operate in it any longer. There were many markets to which the Committee could lend support if it were so minded, and the arguments that Mr. Stone had advanced with respect to acceptances could, in his opinion, be made for other types of instruments as well. He had the impression from Mr. Stone's memorandum that the acceptance market no longer needed assistance, although it was still leaning on the Committee. He had no objection to raising the limit to $125 million, but he thought the Committee should take a fresh look to see whether there was reason to continue to operate in acceptances.

Mr. Hayes said he felt that bankers' acceptances were a type of paper that traditionally, and properly, had been regarded as an important element in a widely-developed and active money market. The encouragement that the Committee gave to the acceptance market was mainly through the psychological effect of its participation, rather than as a result of any substantial cushioning operations. It seemed appropriate to Mr. Hayes for the Committee to encourage use of this instrument in view of its interest in seeing the money market developed as fully as possible.

Mr. Daane said he agreed System participation in this market was appropriate because acceptances were an important money market instrument. It was not proposed to increase System holdings of acceptances immediately to $125 million; the objective simply was to allow a little more latitude in operations that would remain marginal. He could not see anything objectionable in the recommendation.

Mr. Mitchell remarked that he was not opposing the recommendation but thought the Committee should re-examine its reasons for participation in this market. He did not find Mr. Stone's memorandum convincing on this point.

Mr. Shepardson commented that while he agreed with Mr. Hayes on the desirability of maintaining contact with this market, he did not see why it was necessary to increase the dollar limit on operations. The Committee's participation in the market indicated its interest and demonstrated its confidence in this instrument, and it apparently had been helpful to the development of the market in the past. But it did not necessarily follow that the dollar limit should be raised.

Mr. Stone said he thought that the Account's participation had to have some meaningful relation to the size of the market itself; operations had to be on a visible scale to be helpful in encouraging further sound growth and development.

Mr. Mitchell asked what criteria the Desk applied in deciding on operations in acceptances. Mr. Stone replied that all operations were undertaken at the initiative of the Account Management. In general, holdings were modified seasonally, concurrently with the seasonal fluctuations in the volume of acceptances outstanding. When the seasonal tides were running strongly and adding to outstandings, the Account's holdings were increased; when they were not, holdings were left largely unchanged or perhaps reduced a little. He agreed that such operations might have some small tendency in the direction of moderating interest rate fluctuations but added that operations of a size that would have any substantial rate effects were specifically avoided. The scale of operations generally was evaluated in terms of the statement week, and generally involved upward or downward changes of no more than $2 million or $3 million over a week.

Mr. Hickman commented that the Desk was acting in a fairly neutral fashion with respect to interest rates if it maintained a roughly constant share of total outstandings in its portfolio.

Mr. Ellis said the Committee seemed to be moving toward a permanent policy of maintaining a given share of outstanding bankers' acceptances in its portfolio. He had not realized that the Committee was committed to this sort of policy, and he was not sure that he would endorse it. Perhaps the market had grown sufficiently for the Committee to be able to operate in it when it wanted to take some pressure off of the bill market. At the same time, there had been some qualitative changes that were not mentioned in Mr. Stone's memorandum, and it probably could not be argued that the quality of acceptance paper had improved uniformly. In any case, he agreed that at some point the Committee should re-assess its role with respect to this market.

Chairman Martin noted that the Committee reviewed all of its continuing authorizations and directives on an annual basis at the time of its organization meetings. He proposed that the Committee vote on amending the continuing authority directive to increase the limit for holdings of bankers' acceptances as recommended by Mr. Stone, and plan on considering its appropriate role in this market at its next organization meeting, in March 1965.

Thereupon, upon motion duly made and seconded, and by unanimous vote, section 1(b) of the continuing authority directive relating to transactions in U.S. Government securities and bankers' acceptances was amended to read as follows:

> To buy or sell prime bankers' acceptances of the kinds designated in the Regulation of the Federal Open Market Committee in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates; provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed $125 million or 10 per cent of the total of bankers' acceptances outstanding as shown in the most recent acceptance survey conducted by the Federal Reserve Bank of New York.

Mr. Stone then called to the Committee's attention the fact that the Desk heretofore had not entered into repurchase agreements with one of the dealers in bankers' acceptances (M. & T. Discount Corporation), and he reviewed the factors that had underlain the Desk's position in that regard. He also noted, however, that the situation had recently changed, and that the reasons for not making repurchase agreements with the firm in question no longer existed. He indicated that in his view it would be helpful to the market and to the System to make repurchase agreements with the firm and that, if the Committee interposed no objections, he proposed to do so.

In the course of discussion no objections were raised to Mr. Stone's proposal. Chairman Martin commented that it would be desirable in the future for the Manager to submit any proposals of this type to the Committee by memorandum in advance of the meeting at which they were to be discussed.

Chairman Martin then called for the staff economic and financial reports, supplementing the written reports that had been distributed prior to the meeting, copies of which have been placed in the files of the Committee.

Mr. Brill presented the following statement on economic conditions:

> Economists would be hard put without strikes, strike threats, elections, and international tensions to becloud the situation, but I suppose our professional ingenuity would be capable of finding other reasons for hedging. Fortunately, I don't have to be particularly ingenious today, for there is more than enough of strikes, elections and tensions to muddy up the statistics.
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> As best as I can penetrate the murky figures, there doesn't seem to have been any significant change in the pace or character of the economy over the past month, except in the auto industry. Industrial production appears to have increased moderately in areas not directly affected by the strike. Manhour figures used in calculating the bulk of the

current index have just come in, and a cursory examination suggests that the total index will be down by less--perhaps a half a point less--than the 3 points attributable to the General Motors strike alone. Similarly, retail sales appear to have done well in October, outside of automobile dealers. The unemployment figure was not affected by the strike, for strikers are counted as both employed and in the labor force, and the unemployment survey took place at mid-month before there were any repercussions of the strike on other companies or industries. The unemployment rate, at 5.2 per cent, showed little change from the preceding month--or for that matter, from the level that has prevailed for the past five months.

The most recent inventory data are for September, too early to show much effect from the auto strike. The figures do indicate, however, some early response to the threat of a steel strike, a response which may have carried over into October. In addition, the October figures will reflect the reported piling up of steel ordered but not used by GM, but there will be the offset of a sharp reduction in auto dealer stocks. Abstracting from these cross currents, the October figures would probably suggest a continued desire by producers and distributors to rebuild inventories from recent low levels, but no great or widespread surge of inventory accumulation.

One might also take the recent McGraw-Hill survey as a current datum on the business situation. In fact, it is probably more useful in this capacity than as a precise forecasting tool. As a forecast, it would be somewhat discouraging, since the projected year-over-year increase implies very little further advance from current levels for this critical spending area. Even if adjusted generously for the usual understatement of spending plans during upswings, it would not suggest a prospective investment boom of, say, 1956-57 proportions, with the usual accompanying bottleneck price pressures, and the usual deflationary consequences as capacity pulls too far ahead of final demands.

As a measure of current business sentiment, the survey has its encouraging aspects, for it indicates the same caution that has characterized business attitudes throughout this expansion. It is evident that businessmen are not building their longer-run spending plans around prospects of inflation, and it appears that whatever steel stock-piling is going on is probably more in fear of production interruptions than as a price hedge. In fact, direct questions on the price situation elicited answers suggesting that businessmen expect continued general price stability.

Recent developments have been conducive to this sort of price outlook. Significant price pressures have been largely confined to the nonferrous metals area, and have been offset by decreases elsewhere. As our "green book" analysis indicates, there has been no follow-through from spot markets for raw materials to the broader price measures, in sharp contrast with earlier cyclical experience. By the time the spot index had risen 20 per cent in the 1954-56 upswing, the over-all industrial commodity index had risen 3 per cent. The spot index has risen 20 per cent again since the summer of 1963, but the over-all index has increased only three-tenths of one per cent in this period. This is partly because outside the nonferrous metals area many items have shown little or no change, partly because many of the larger increases have been for items with little weight in the over-all production picture, and partly because there have been offsetting declines. To date, it's been a wonderful demonstration of the social effectiveness of the market process, when it can operate in the context of a fairly balanced and gradual expansion.

Steel is a critical determinant of whether this over-all stability will be maintained, because of steel's direct importance in the production process and also because of its psychological impact. To cite history again, steel mill product prices were raised as early as mid-1954, only shortly after the spot index had begun to rise, and when steel operating rates were less than 70 per cent of capacity. The steel increase was reflected in higher auto prices by that fall and in higher machinery prices by winter. The second and larger steel price increase occurred in mid-1955, when operating rates were well over 90 per cent, and triggered a widespread advance that raised the index for all industrial commodities by close to 10 per cent in the next year and a half.

The demand and supply situation of the 1960's, for steel and generally, is quite different, both here and abroad, from that of the mid-1950's, and one can hope that steel producers and labor leaders are not too obtuse to recognize this. The internal power struggle in the steel workers' union, and the industry's insistence on financing expansion through higher prices and earnings rather than by resort to the capital market, may blind both participants to current economic realities. Under these circumstances, even though one may deplore Government intervention in the market determination of wages and prices, on both domestic

> and balance of payments grounds one can justify at least a vigorous presentation of the public's interest in a prompt and reasonable settlement. This is apparently being done by the Executive Branch, and there doesn't seem to be any point to "jumping the gun" with monetary policy, especially since there is little if anything else on the domestic scene to warrant any shift in policy.

Mr. Deming commented that he was a little mystified by the performance of the wholesale price index. As he had mentioned at previous meetings, the Minneapolis Bank regularly surveyed large firms with headquarters in the Ninth District, and recent returns indicated without question that the average prices of goods these firms manufactured and sold had been going up. In October six firms, or about a quarter of those contacted, reported that they recently had raised prices, and nine others expected to make increases before the end of the year. No firms reported price declines. While the increases on the whole were not large, and while some may have been partly of a seasonal nature, he would expect that tendencies of the sort found in the District would be reflected in the national indexes.

Mr. Brill observed that the indexes did reflect many price increases, but taken together such increases were neither large enough nor numerous enough to offset the decreases that were occurring simultaneously. For example, lumber prices had been declining--which was not surprising in view of developments in construction--and so were petroleum prices until recently. And domestic tin prices had fallen in a delayed reaction to releases of tin from the stockpile.

He was not mystified by the stability in the over-all wholesale price index, particularly since steel prices had not been rising.

Mr. Hayes remarked that he was impressed by the results of the purchasing agents' survey for October, in which 41 per cent of the agents reported increases in prices of items they were buying. Except for October 1963, this was the highest figure in six years. It was his feeling that upward price movements were distinctly dominant.

Mr. Holland made the following statement concerning financial developments:

> For the financial system as well as for the real economy, October proved to be a month of tempering developments.
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> Most financial aggregates showed more moderate changes. The September surge of credit demand, that had tightened money markets and bulged bank credit and money supply totals, seemed to be dampened in first one area and then another as October progressed. Before the end of the month, the moderating influence had spread quite generally through the system.
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> A number of elements seemed to contribute to this pattern, including the large size of some temporary financing needs in September, and perhaps some over-borrowing and overaccumulation of cash in that month in anticipation of later fall needs. In addition, there was some corporate cash accumulation in October because of the auto strike that permitted temporary reductions in borrowing needs and unseasonal investment in money market assets.
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> Given this intermingling of influences in September and October, the most expedient way to appraise recent financial changes is to average the statistics for the two months together. When one does this, the growth in total bank credit, on a daily average basis, appears as just under an 8 per cent annual rate, within the 7-8 per cent range of growth that has prevailed on average in each of the intervals between the changes in monetary

policy during the past two years. The September-October average money supply growth was at a 5.3 per cent annual rate, slightly above the year-to-date average of 4.2 per cent, and similarly higher than the 4 per cent rate of rise in real GNP through the third quarter. But as the projection show at the last meeting of the Committee pointed out, such a pace of money growth can be conceived as within the capacity of the economy to use and absorb without necessarily having inflationary consequences.

The only immoderate-appearing figure in the October financial reports was the stepped-up rate of increase in time deposits, at a 14 per cent annual rate. Partly, this reflected an aggressive and successful effort by some of the larger banks to build up their CD totals (the first real push in this direction since last July). This occurred on top of a resurgent rate of growth in savings-type deposits, a phenomenon that had been developing for three months now and that seems fairly broadly spread through the banking system. Deposit-type savings institutions other than banks have also been reporting strong net inflows, suggesting a continued moderation in the consumer's approach to spending his funds and a turn in favor of intermediaries over market instruments as a channel for savings, after a contrary movement had emerged temporarily last spring.

Insofar as corporations are concerned, their more willing purchases of CD's in October were also accompanied by some selective acquisitions of other money market assets again, after heavy September liquidations. Over the same period, business borrowings at banks assumed a more moderate cast; we are estimating seasonally adjusted business loan increases at commercial banks in October of only $200 million, the smallest since March. Some of these money market and bank loan movements are known to be associated with the auto strikes, and may not be washed out until sometime in December. Making such allowance for the strike effect as one can, however, the judgment seems warranted that underlying corporate needs for external funds have dropped back from their September spurt, even if they were continuing to run above the more flaccid rates evident earlier in the expansion.

The combination of somewhat reduced demands for outside financing and the continued large flow of savings helped in infusing a better tone into the securities markets in recent weeks. In the money market proper, however, indicators have fluctuated a good deal, for reasons that Mr. Stone has already described. And the continuing changeability of the money market and bank credit picture was demonstrated again in the past two weeks, by the brisk run-up of private deposit expansion and money market pressures in the past week of November 4, only to be followed by some apparent fall-back in deposits in the current week.

It is fair to ask what analytical significance, if any, should be attached to the kind of bulges in money and credit demands that have been experienced recently. Let me suggest a few tentative conclusions, I hope expressed with enough diffidence to suggest the fragmentary nature of some of the evidence and the still unproven linkages in several steps of the argument.

The attractive levels of short-term interest rates--at least by domestic standards--and the numerous innovations in the types and terms of near-money instruments, have cut down the cushion of idle balances on the nation's money stock. One consequence is that cyclical, seasonal, or even temporary swings in the needs for money for transactions purposes are likely to be mirrored to a greater extent than before in bulges in the outstanding money supply, and also in pressures on money markets as businesses and individuals try to dispose of liquid assets or borrow in order to obtain cash balances from time to time. These changes in money and credit demand can be quite choppy, not just because of inertia and slippages in the financial mechanism, but because the whole complex of decision-making in a free economy permits a good deal of short-run variability in the choice and timing of actions.

These short-run financial changes are not meaningless, I would argue, given present interest rate levels, but rather are often indicative of changes that are also underway or in prospect in demands for other assets. If this is true, then the question of how long and to what extent monetary policy should accommodate these financial changes has to depend primarily upon how well the economy can accommodate attendant or consequent changes in real demands, and secondarily on how long it might take monetary policy to exercise a countervailing influence if desired. Right now, with rates of resource utilization higher than last year, the margin for accommodation of upswings in demand appears narrower than a year ago when we were likewise facing a bank credit and money supply bulge.

> In prospect after the turn of the year, however, is a sharp and more-than-seasonal swing in the Federal Government's position, from that of a net borrower toward that of a net saver. In the process, an additional margin of both real and financial resources should be released to meet private demands. That development, if it materializes, should permit monetary policy to accommodate somewhat greater private bank credit and money increases than would otherwise be the case. Indeed, given the undoubted lags with which monetary policy affects real demands, this may be none too soon to take some account of such fiscal prospects in current monetary policy deliberations.

Mr. Hickman referred to Mr. Holland's comment about the expected change in the Federal Government's budget position in early 1965, and asked whether Mr. Holland meant that this was something the Committee should take account of now by providing sufficient credit for the private economy to expand and take up the slack. He noted that there usually were seasonal swings in the Federal budget.

Mr. Holland replied that the significance of the swing in the Federal budget in this fiscal year was that it was expected to be larger than seasonal, and to result in a greater than usual degree of fiscal restraint on the economy in the first half of calendar 1965. Given the lags in monetary policy, it might well be appropriate for the Committee to take some account of this expectation now.

Mr. Hayes asked whether the Committee should not also take account of the possibility that developments elsewhere in the economy, for example, in inventory accumulation and consumer spending, would offset this fiscal restraint. In his judgment, the economy had considerable momentum.

Mr. Hickman commented that economists associated with large firms in the Fourth District at a recent meeting were almost unanimously of the view that production and aggregate demand would be rising in the first half of next year. He felt that monetary policy should be geared to developments in the aggregate.

Mr. Holland agreed that the Federal budget was only one element in the whole picture, but added that it also was the one that seemed to be changing most rapidly. Inventory accumulation currently was at a moderate level, and he knew of no important changes in other areas that were coming into view at present. General economic activity might or might not rise to inflationary levels next year, but fiscal policy would be moving in a direction to help monetary policy dampen any such movement.

Mr. Balderston asked Mr. Holland to interpret for the Committee the annual rate of change in seasonally adjusted nonborrowed reserves during the months of August, September, and October. He noted that this rate was 5.4 per cent, as compared with 3.3 per cent for the preceding period of a little more than a year. Was this increase a matter about which the Committee should be concerned?

Mr. Holland replied the higher rate of expansion reflected the pull on reserves supplied by the System of the expansion in demands for credit that developed through September and, on the whole, continued in October. Since the Committee used marginal reserve positions as a major guide to policy, when credit demands led to rises in bank indebtedness the System provided additional reserves. The change to which Mr. Balderston referred thus was a consequence of the System's response to credit demands under its current policy posture.

Mr. Shepardson asked whether the expected increase in Federal Government receipts in early 1965 was mainly a result of rising levels of economic activity, and Mr. Holland replied in the affirmative. Mr. Mitchell commented that some part of the expected lumpiness in Federal receipts was due to under withholding of personal income taxes. Mr. Brill added that much of the increase would reflect corporate tax payments in 1965 on profits made in 1964, which were sharply higher than in the preceding year.

Mr. Reynolds presented the following statement on the balance of payments:

> In a few days, the Commerce Department will announce that the U.S. payments deficit on "regular transactions" in the third quarter was at an annual rate of \$2.3 billion. This rate is down a bit from the second quarter rate of \$2.7 billion, but the decline is not significant, and is not as large as press reports may have led people to expect.
>
> For the period since the third quarter ended, weekly indicators show no significant change in the deficit. While the unadjusted deficit may have risen to something like \$600 or \$700 million in October, the increase appears to have been little more than seasonal. There was the usual large outflow of funds into U.S. dollar deposits with Canadian banks, which seek such funds to build up the balance sheet totals that they publish for October 31.

One factor that tended to increase the deficit in October was an increase of more than $100 million in U.S. purchases of new foreign bond issues, as a backlog of Canadian issues came to market following enactment of the interest equalization tax. Heavy Canadian borrowing will continue this month, to the tune of about another $100 million. Also, the Inter-American Development Bank is borrowing $100 million here this month, although that issue will not have any immediate effect on the payments deficit, since the proceeds are to be placed in long-term time deposits here, thus producing an offsetting capital inflow. The total of new foreign issues this quarter may be $400 to $500 million, close to the record amounts of early 1963.

The main constituents of the over-all payments position continue to be a large surplus on current account and an even larger deficit on U.S. private and Government capital account. The surplus on goods and services actually increased in the third quarter, mainly because export shipments were speeded up in September in anticipation of a port strike, which did not materialize, thanks to a Taft-Hartley postponement. The fact that imports have not risen faster than exports, as was earlier feared, is encouraging.

Data on capital flows in the third quarter are still incomplete. Extensions of bank credit to foreigners through loans and acceptances, on which we do have firm data, increased a little, contraseasonally, as a sharp increase in long-term lending outweighed a decline in short-term lending. On the other hand, there is no evidence of any net outflow of liquid U.S. funds in the third quarter, whereas there had been such outflows in the second quarter. Also, U.S. purchases of new foreign security issues fell off sharply in the third quarter and net transactions in outstanding securities continued small.

These pieces add up to some moderation in reported capital outflows during the third quarter from the very high rate of the first half year. However, this decline, taken together with continued strength in the current account, cannot easily be squared with the continued high rate of over-all deficit. Even after allowing for the possibility that direct investment outflows and Government grants and credits may have increased a little, we are left with a substantial increase in net unidentified payments--the "errors and omissions" item--which presumably is to be ascribed in part to an increase in unrecorded capital outflows.

The facts so far surveyed may be summarized by saying that the over-all deficit has remained large, and total outflows of U.S. capital have remained very large, although neither has increased significantly since last spring. Thus, if recent balance of payments developments are cited in support of the need for firmer monetary policies, the argument must be that the deficit and the capital outflows have remained too high for too long, rather than that there has been any clear deterioration recently. The argument is strengthened by near-term prospects. There seems little reason to expect any diminution in capital outflows or in the over-all deficit during the current quarter. And in the absence of Russian gold sales, we are beginning to see some declines in our gold stock, as Mr. Sanford noted.

Firmer credit conditions in this country might serve particularly to restrain bank lending to foreigners, which amounted to about $1-1/2 billion in the year through September, and which was at about that rate in the third quarter. Any beneficial effects on other flows would probably also come more from changed availability of credit than from changing interest-rate differentials, since Britain and Canada would probably have to move their rates in step with ours, and since monetary policies in several Continental European countries still lean towards tightening.

Mr. Mitchell asked if there was any way of estimating the impact of the new British trade restraints on U.S. exports, and Mr. Reynolds replied that the staff had made some crude estimates. United States exports to Britain currently were at an annual rate of about $1-1/2 billion, and roughly half of the goods involved were subject to the surcharge. The staff estimate was that the tax would reduce exports by an amount in the neighborhood of $100-$200 million, at an annual rate. Much would depend upon how temporary the tax seemed likely to be; if it was expected to end soon, the reduction might well be larger than this because some traders might decide to wait it out. However, it was Mr. Reynolds' impression that few expected the tax to be taken off at any time soon.

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:

> Basically the domestic economy appears to be strong, although we are currently passing through a phase of some uncertainty, as observers move into the annual period for worrying about what may happen next year. Unfortunately, the General Motors strike has added to the uncertainty by producing important declines in many statistical series, probably to be followed by sharp rebounds in later months.
>
> I would expect continued business expansion well into 1965, taking into account the favorable outlook for consumer spending, plant and equipment outlays, inventory accumulation and State and local spending. I have been impressed by the strength of consumer outlays in the third quarter and the likelihood that the influence of the cut in income taxes is not yet exhausted. The key area of business plant and equipment expenditures is also encouraging in the light of various recent surveys, as well as the relatively high rate of capacity utilization and the high level of profits. I would not expect Federal spending and residential construction over the coming months to provide much impetus to further expansion.
>
> As for prices, it is true that the over-all indices at both the consumer and wholesale level continue to show marked stability; and the possibility of a big outburst of inflationary psychology has doubtless been dampened by the President's attitude towards a general steel price increase. On the other hand, the sensitive index for all industrial commodity prices has continued to move up, and specific price announcements continue to be overwhelmingly on the upside. There is ample reason for concern over the possibility of increased price pressures in the coming months, probably stemming more from wage pressures than from demand pull.
>
> October is shaping up as a month of heavy deficit in the balance of payments. To a considerable extent this is a seasonal development; corporate flows to Canada and tax payments by petroleum companies to Venezuela always boost the deficit in the first month of each quarter. Nevertheless, there may have been some basic deterioration from September, if for no other reason than the increase in Canadian securities issues placed in New York. Bank lending abroad in one form

or another remains high, as does the aggregate of private capital outflows--although there have been marked changes from time to time in the composition of this aggregate. There seems to be no reason to expect the fourth quarter to show any improvement over the third quarter deficit of about a $2.4 billion annual rate. Hence, the deficit for the year could easily reach $2.1 billion. We seem to be faced with a persistent deficit at this unsustainably high rate, despite the marked progress shown by the trade balance over the last year or two. As a result, there has recently been a noticeable hardening of the attitude of the surplus countries toward the United States.

In analyzing bank credit developments, I would be inclined to minimize the importance of month-to-month swings and to stress rather the rates of growth for the first ten months of this year as a whole. It is noteworthy that total bank credit has grown at a rate somewhat higher than in the same period last year, and the growth of the money supply is also running slightly ahead of last year. Business loan demand, while not spectacular, has been considerably ahead of 1963, and fairly good strength in credit demands seems likely for the remainder of this year.

Since capital outflows play so large a part in our persistent balance of payments problem, monetary policy can and should be employed in alleviating that problem. I do not have in mind here a "crash program" to deal with a sudden new crisis but rather a moderate sustained effort to help cope with a drain that is cumulatively eroding our international economic position. And while the present statistical position of the domestic economy might not, in isolation, justify a change in policy, it seems to me that the economy is fully strong enough to withstand a moderate change without damage. In fact, given the rapid growth of bank credit so far this year and the existing threat of inflationary developments, I feel there may well be a good deal of merit from a domestic standpoint in some slight change in the System's posture at this time, especially when we consider how damaging any inflationary tendencies would be to our international position.

We should probably maintain current policy until the Treasury's refunding program is out of the way. Thereafter the coast seems clear for policy modification without the need to consider the even-keel factor. It would seem to me wise to conduct open market operations, starting about a week from now, with a view to encouraging somewhat firmer money market conditions than have prevailed in the last month or two. The objective of this policy change would be to achieve a moderately slower expansion in bank credit and a firmer short-term interest rate structure, both of which could be decidedly helpful in connection with our international accounts. Specifically, I would think in terms of a range of free reserves around the zero level, but more often below zero than above it; I would envision the numbers falling frequently in the range of zero to $50 million net borrowed reserves, recognizing, of course, that there would be swings outside of this range on both sides. Hopefully the 90-day bill rate might, under these conditions, be expected to move up to about 3-3/4 per cent, and borrowings would be expected to exceed recent levels.

I don't think it is necessary at this time to prejudge the possible consequences of this moderate change in open market policy in terms of future discount rate action. I am aware that the increase in short-term market rates would set in motion considerable expectations along these lines, but I think there would be no particular difficulty in discount administration, at least for a period of several weeks--and we shall, of course, have an opportunity to review this situation on December 1. It will, of course, be necessary to consider the effects of any discount rate move in this country on rate policies abroad, especially in the U.K. It seems not unlikely, however, that the U.K. may be moving in the direction of a higher Bank rate for reasons related entirely to the British situation itself. It is clear that the tighter credit conditions that have developed on the Continent in the past year have had an adverse effect on both the British situation and our own.

With respect to the directive, I would suggest a material change in wording if the Committee agrees on the wisdom of the moderate policy change I have proposed. I am satisfied with the second paragraph of the staff's alternative B (omitting the last clause on bank reserves, as so many of the Committee members proposed at the last meeting); but it seems to me that the first paragraph could be improved, to give a clearer picture of the reasons for our policy change. 1/ I have some language to suggest at the appropriate time.

1/ Alternatives A and B of the draft directive referred to by Mr. Hayes, and subsequently by others, are appended to these minutes in Attachment A.

I think it might be well for us to have in mind that, in the event of any rise in short-term market interest rates reflecting an intentional modest shift of policy, there would be a risk of a severe squeeze on the banks as long as the present ceiling is maintained on time deposit interest rates under Regulation Q. Indeed, we may be close to running into a squeeze of this sort even without a further firming of policy. Major banks are now ready to pay 4 per cent for four-month or, on occasion, even three-month maturities; and under these conditions it may be difficult for banks outside of the money centers to retain their interest-sensitive time deposits--which, incidentally, have shown little or no growth since mid-summer. Of course, this difficulty might become applicable even to the major banks if interest rates were to experience some further rise. It would seem highly appropriate, therefore, that the Board of Governors give this matter careful consideration, in order to prevent a more intensive tightening of bank credit than any of us would like to contemplate.

Mr. Shuford observed that as had been pointed out this morning economic activity during the fall had continued to rise markedly despite interruptions in the automobile industry that were adversely affecting the October data. The prospects for further growth remained favorable. From the second quarter of this year to September, industrial production in the nation rose at a 6.5 per cent annual rate, and manufacturing output in the St. Louis District increased at an estimated 8 per cent rate. In both the nation and the District payroll employment had continued to rise faster than the working-age population. Business loans as well as other major groups of bank loans had been rising rapidly both in the District and in the nation.

For several years, Mr. Shuford said, it had been a chief objective of monetary policy to take actions that would foster expansion in the total demand for goods and services. An appropriate volume of reserves had been supplied for a moderate growth in money supply, and the demand for goods and services had been rising at a strong rate. The result had been a rise in real output with few price increases. The balance of payments, although still troublesome, had not deteriorated. It seemed to Mr. Shuford that the record evidenced an appropriate monetary policy during this period of economic expansion.

In the last two or three months, Mr. Shuford continued, monetary expansion had been at an annual rate of about 5 per cent rather than 8 per cent as in June and July. But even 5 per cent was a relatively rapid rate, and he thought that a slightly lower rate would be more appropriate to the present state of the economy. Economic activity appeared to be rising somewhat faster than could be sustained over the long run, and the economy appeared to be approaching the optimum use of capacity consistent with reasonably stable prices. While the Committee should hesitate to make definite forecasts, it had to bear in mind that monetary expansion customarily took effect with a lag.

Mr. Shuford believed, therefore, that monetary actions should be somewhat less expansionary than they had been in recent months. He would not want to clamp down forcefully, and he did not even advocate a change in the Committee's proximate goal of providing for moderate growth in bank reserves and the money supply. He would, however, like to see the growth rates in bank reserves and the money supply return to the 3 or 4 per cent range that had prevailed over the past two years.

More moderate growth in reserves and the money supply seemed likely to necessitate somewhat less easy money market conditions, including higher interest rates and some net borrowed reserve figures. Mr. Shuford thought the Committee should be prepared to accept such necessary developments. Moreover, higher interest rates might also be appropriate for the balance of payments problem. He recommended, as soon as appropriate after the current Treasury financing, that a step be taken toward less easy money market conditions with a view to moderating the rate of monetary growth and other stimulative aspects of the System's actions.

As for the directive, Mr. Shuford said he found alternative B of the staff's drafts acceptable with one or two minor changes. The second paragraph was satisfactory to him with the bracketed phrase retained. In the first paragraph, he favored omitting two phrases relating to the balance of payments. He recognized that the payments balance was a continuing problem, but it had not shown any further deterioration recently, and his position on policy was not motivated by it. Accordingly, he would leave out the phrase in the first sentence of alternative B which read "while placing somewhat greater emphasis on fostering improvement in the capital account of U.S. international payments." Similarly, in the last sentence of this paragraph he would omit "and the possibility of some adverse effects on the deficit of the recent slowing down of economic activity in Europe." Mr. Shuford did not favor a change in the discount rate.

Mr. Bryan remarked that in reviewing recent statistics for the Sixth District he did not see any significant differences from the trends in the nation as a whole. Perhaps the District was in a slightly better situation than the nation with respect to construction contract awards, but even in this area it showed much the same tendencies as the nation. Over the longer term of a year or so, most of the figures showed that the District had been moving ahead of the nation, although that statement was subject to one or two exceptions. His view of the national economy was that it was performing adequately, although he would wish that the unemployment statistics had a better face.

Mr. Bryan advocated no change in policy for the immediate future--specifically, for the next few days. As he conceived it, that would mean free reserves somewhere in the neighborhood of $50 million. At the same time, he thought the Committee was getting itself into a box by never showing a negative free reserve figure, and that the sooner it got out of that posture the better off it would be. If free reserves remained positive for a long period and it then became necessary to show a negative figure, this could easily give the market a substantial jar with consequences that would go far beyond what the Committee intended. Accordingly, when the Treasury financing was over, he would like to see free reserves fluctuate around zero, occasionally on the negative side and occasionally on the positive. Having said that, Mr. Bryan continued, he would add that he again was getting concerned about the use of free reserve figures as a guide to monetary policy. Once more he was leaning towards use of total reserves as a guide.

Mr. Bopp reported that economic activity in the Third District now compared well with national levels. Unemployment in most major labor markets was lower than at any time since the mid-fifties. Manufacturing output and employment were climbing steadily, with manufacturers of durable goods turning in especially good records. Sales at department stores were strong, although the rise in the Third District had not been quite so vigorous as in the nation.

On the financial front, the basic reserve position of reserve city banks had eased somewhat Reflecting this easier tone, reserve city banks had not borrowed during the last two weeks of the most recent reporting period and Federal funds and other borrowing had dropped substantially. For the three weeks ending November 4, total loans and investments (adjusted) increased, with most of the increase arising from increased loan activity.

Economic activity appeared to be continuing along a course of moderation, Mr. Bopp said. Inventories, wholesale prices, and the rate of output relative to capacity all reflected the moderate pace of business, a pace with which one might well be pleased if it were not for the stubborn cling of unemployment above 5 per cent of the labor force.

Moderation also was reflected on the financial front. The somewhat slower rate of increase in the money supply in October was a desirable development, in Mr. Bopp's opinion, even though one month's data could hardly be more than suggestive of future trends.

Although not necessarily surprising, the October deficit in the balance of payments was discouraging. The behavior of the deficit would bear close scrutiny in coming months, especially the capital sector where the U.S. might experience further outflows of funds in the form of long-term bank loans and purchases of foreign securities.

As for the future, Mr. Bopp continued, some had expressed concern over the possibility of overheating of the economy in the months ahead, as automobile manufacturers rushed to catch up in output and as manufacturers and others stockpiled steel in an attempt to beat the May strike deadline. Even if this development were to materialize, there were a number of factors which suggested a slow-down in the longer run. Included here were the likelihood of a reduced rate of increase in capital spending and a leveling in both Federal Government and housing expenditures. It was the longer-run possibility that seemed to Mr. Bopp the more important, and he saw some danger of being unduly influenced by the possibility of a rapid surge in business activity in the short run.

Mr. Bopp felt, therefore, that about the same degree of ease prevailing in recent weeks continued to be appropriate. He would not feel uncomfortable with a three-month bill rate closer to the 3.60 per cent level. Within a policy of essentially no change, he would not quarrel with a slight firming in the money market. The discount rate should be held at the present level, and he favored alternative A for the directive.

Mr. Hickman said that the auto strike had been the major influence on the economy in October, with adverse effects showing up in industrial production, personal income, and retail sales. Steel production had continued unchanged at high levels. Some rebound might be expected in the economy in November, although the extent would be restrained by continuing disputes over local issues in the auto industry.

Some light on future prospects for automobiles and steel was provided at the Bank's quarterly meeting last week of 25 industrial economists, representing large corporations headquartered mainly in the Fourth District. The consensus was that the auto strike had knocked about a half million cars from this year's production, most of which would be carried over to next year. This meant that auto production was now estimated at 7.8 million cars for 1964 instead of the 8.3 million previously anticipated. Likewise, total car sales, including imports, were now expected to amount to 8.1 million cars instead of 8.2 million. Whereas formerly it was considered a close question whether 1965 would match 1964, it now appeared that production next year might go as high as 8.1 million cars and total sales as high as 8.3 million, with both production and sales exceeding this year's levels.

District economists representing the steel industry expected this year's ingot output to total 126 million tons. It was estimated that steel consumption in 1964 would amount to the equivalent of 116 million ingot tons, and that 10 million tons would be added to inventories. Next year steel consumption was expected to increase slightly to 118 million tons, ingot equivalent. With no further net increase in inventories anticipated for the year as a whole, this would mean production of 118 million ingot tons as against 126 million this year, for a decline of about 6 per cent.

Forecasts of the index of industrial production made by this group of economists showed modest gains during the current quarter and in the first half of 1965, with a large majority expecting a level in or a slight decline in the third quarter. Of the latter group, about half looked for an inventory spurt and then a slump, and the remainder for a gradual and pervasive weakening of demand throughout the economy.

Mr. Hickman said he continued to be concerned about current monetary policy. He had been on the conference call during the past three weeks and had followed developments closely. Early in the period it looked as though a free reserve figure of $50 million was equivalent to a marginal credit supply sufficient to bring the rate of expansion in bank credit and the money supply down to sustainable levels. At least, the figures seemed to reflect this for most of October up to the reserve period ended October 28. In the next week, however, a sharp spurt in required reserves coupled with other factors almost caused free reserves to fall below zero. This might mean that credit demand was too strong under present conditions to be held within sustainable bounds by a free reserve level as high as $50 million.

With the comfortable cash position of the Treasury resulting from the recent financing, Mr. Hickman continued, the calendar should be clear after the next few days throughout the remainder of the year. The System, in his opinion, should use this opportunity to probe very slightly and very gently toward less ease. Quantitatively, he suggested a free reserve target of about $25 million plus or minus $50 million. Thus, he came about out where Mr. Shuford and Mr. Bopp had, but a little above Mr. Hayes. If this almost imperceptible shift in policy failed to bring rates of growth of bank credit and the money supply down to sustainable levels, which he would take to be about 4 per cent under current conditions, the Committee might have to move to zero free reserves. This recommendation, in his opinion, would not require any change in the substantive portion of the directive, and, hopefully, would not result in a change in the discount rate.

Before closing, Mr. Hickman said, he would like to comment briefly on some recent changes in his District that might conceivably have a major impact on savings flows. In Columbus, commercial banks had raised rates to 4 per cent early in August, in effect eliminating the differential that had previously favored savings and loan associations. Immediately, there had been a sharp increase in savings deposits at Columbus banks and a marked slowdown in the rate of increase of savings shares. In Cleveland, the savings and loan associations had just informed him that they would like to reduce dividend rates at the beginning of next year from 4-1/4 per cent to 4.1 per cent for those compounding interest quarterly and from 4.3 per cent to 4.15 per cent for those compounding semiannually. The savings and loans felt that they were unable to compete with commercial banks at the current rate of 5-1/2 per cent on mortgage loans with 80 per cent loan-to-value ratios, and must discourage further large inflows of funds by reducin dividend rates. These changes, if they spread throughout the economy, could clearly have important consequences for monetary policy and for evaluating present rate ceilings under Regulation Q.

Mr. Hickman concluded by noting that he had a redraft of the staff drafts for the directive, combining elements of alternatives A and B, that he might offer for Committee consideration at a later point in the meeting.

Mr. Daane observed that the problem confronting the Committee at this meeting seemed unusually complex. He started from the premise that the Committee's policy had been too accommodative for too long. He had not been completely convinced by Mr. Mitchell's arguments in favor of such a policy in his Arden House speech this past week end and he found it significant that Mr. Mitchell had made no reference to the balance of payments in this speech.

At this moment, Mr. Daane said, he would have felt more comfortable if policy were somewhat less accommodative with respect to both bank reserves and the price of money. Despite his discomfort with the present posture of policy, however, he could not see any clear advantage from a timing standpoint in making a move at this juncture. On the domestic economy, it seemed from the staff review that the case for making even a slight move toward less ease was somewhat weaker now than it had been at the previous meeting. This was indicated by developments in capital spending plans, construction, and inventories, for example, and in the financial area by the most recent changes in bank credit and the money supply. The balance of payments remained a serious problem, but as Mr. Hayes had said it had not been worsening recently. On the whole there was little that was really new in the balance of payments situation; for much of the year the Committee had been discussing a 1964 payments deficit of about $2 billion, and there were no additional grounds now for undertaking a program to combat the balance of payments deficit.

The Committee did have an operational problem, Mr. Daane continued. The situation at present was analogous in some respects to that at the meeting in August. As was the case then, a firmer condition already was established in the money market prior to this meeting--free reserves for the most recent statement week were only $5 million. His view in August had been that the Committee should try to maintain the firmer conditions that had come about, and similarly he now felt that it would be desirable to keep free reserves as close to their current levels as was feasible. He did not think it was possible to move to mainly negative figures in the course of a gentle, probing shift, because continuing negative reserves would be read by the market as a clear signal that the Committee was changing the posture of policy. A premise underlying the current rally in the bond markets was that monetary policy changes were not imminent in either the United States or Britain, and an indication that this premise was wrong would be followed by considerable changes, wiping out the rally and going well beyond what the Committee intended. It would not seem to be meaningful to make such a policy shift unless the System was willing to couple it with a discount rate change. This, in turn, would have many international consequences, and it was a step the System could not take lightly.

Mr. Daane's conclusion was that, while it was rather distasteful to seem always to be in a position of advocating no change in policy and passive accommodation, he would still favor maintaining current market conditions until the next meeting of the Committee. He would not favor allowing the market to get a signal in the form of net borrowed reserve figures until the Committee wanted to take a positive step in the direction of less ease, although he recognized the difficulties the Desk faced in avoiding negative figures. He preferred alternative A of the draft directives and he would make no change in the discount rate.

Mr. Mitchell said that he had found a good deal of reassurance in some of the events of recent weeks, including the McGraw-Hill survey of capital spending and the consequences of the strike in the auto industry. At several recent meetings there had been extended debate about the desirability of referring to the auto strike in the directive, and about the likelihood that it would lead to a rash of wage increases. But the General Motors settlement, it seemed to him, had produced the impression that this was an industry that was not giving in easily to inflationary wage demands. He found this highly reassuring as an indication of psychology in current wage negotiations.

The effects of the strike in dampening down the economy had already been noted, Mr. Mitchell said. So had the possibility there might be a letup next year in the pace of the expansion, or even a downturn. Mr. Mitchell thought the latter were not necessary developments, and could be avoided. On the other hand, monetary policy could be the straw that brought them to pass. In his judgment policy should be kept about as it was in the absence of any specific contrary indications.

Mr. Mitchell said he was much in sympathy with Mr. Daane's closing remarks. He thought the Committee should not undertake probing actions that might upset the bond market and the British situation without having any great benefit for the economy. While he could not feel very concerned about a reduction in the free reserve target from $50 million to $25 million, he thought it would be better not to risk giving the impression that policy had changed and thus possibly setting off reactions here and abroad, unless the Committee felt there was a very strong need to do so. Any small move that the Committee made might force a change in the discount rate, which would have highly significant implications. This was another reason for keeping policy unchanged. Mr. Mitchell favored alternative A of the draft directives.

Mr. Shepardson said he did not think he could add to the analysis of the economy that already had been given. While there were some conflicts among the indications of the various indexes, it seemed to him that the Committee had been in a position for too long a time of having, inadvertently or otherwise, a greater rate of expansion in bank credit and the money supply than was desirable. No time ever seemed to be the right time to make a change, yet at some point the Committee had to get on a little firmer basis than it was at present. In his judgment, the Committee had hesitated for too long; a further shift to slightly less ease might have been made three or six weeks ago. In any case, he thought the Committee should move to a little less ease now. He did not favor going as far as Mr. Hayes had suggested, but the general level of free reserves should be reduced somewhat, and the Committee should be prepared to accept negative free reserves from time to time.

Mr. Shepardson was not sure how the Committee should view the rate of money supply expansion. This rate had varied in periods when there had been no change in the objectives of policy. He was not disturbed by short-run fluctuations, but the longer-term expansion this year seemed to him to have been at a higher rate than should be expected to continue.

In sum, Mr. Shepardson said, he favored a little less ease than at present. He did not think this would presage a change in the discount rate; he did not anticipate that much of a change in policy at this time. He preferred alternative B for the directive, but, as did Mr. Hayes, he would like to see some rewording of the first paragraph.

Mr. Robertson made the following statement:

> The evidence the staff has laid before us today clearly indicates that now is not the time to undertake any venturesome change in monetary policy.
>
> Business activity has been given pause by the work stoppages in the automobile industry. Partly because of that fact, business inventory accumulation has been more moderate than earlier forecast, and we are not--in my judgment--seeing any important spread of wage and price increases of inflationary proportions. Signals from the financial side are confirming the moderate pace of business activity, with money supply and bank loan and investment statistics now presenting a distinctly calmer picture after the flurry of a month or so ago.
>
> I was one of those around this table who voiced some concern last summer about the possibility of a build-up of inflationary momentum this fall. But I must say that the facts in hand give no hard evidence of such a development. Hence, concern about inflation still has to be in terms of future possibilities rather than today's actualities.
>
> When one tries to look toward future possibilities, he must at once be impressed with the absence of ebullient prospects. The new survey of capital spending plans calls for holding the present level, or not much more. Even before that information was available, the staff projection show at the last meeting envisioned a very moderate amount of economic growth, with a steadily more restraining influence being exercised by the Federal budget. Comments in the credit and capital markets, I understand, are beginning to emphasize more the large amount of savings that will need to be employed in 1965, and less the possibility that credit demands might exceed supplies of funds and continue upward pressures on both interest rates and productive capacity. Our ability to produce has in fact been growing almost as fast as our increase in actual output, and as a result both capacity utilization rates and unemployment

have changed relatively little recently. Our margin for further expansion of production and incomes is still substantial.

Given these possibilities and allowance for lags in the effectiveness of monetary policy, a System tightening action now might result in some very untimely downward pressure on the economy next year.

There are several other factors--of a lower order of importance--that also weigh on the side of no change in current monetary policy. One is the desirability of avoiding any unnecessary pull of capital away from Great Britain, at a time when she is struggling to deal with a far worse balance of payments position than ours without resort to any escalation of interest rates. Another is the futility of trying to deal with the complex of Canadian-United States capital flows with interest rate changes here, given the inter-governmental agreements already in operation to influence reserve movements between the two countries. As a matter of fact, the third-quarter data cast doubt on the wisdom of relying on interest rate changes to deal with balance of payment problems. Those data show a cessation of outflow and probably an inflow of short-term funds to the United States during a period when a number of international interest rates widened their spread over their U.S. counterparts. Another factor which should be noted is that the Treasury is still in the process of winding up its November financing. While those operations have been routine, still they would suggest--other things being equal--no change in policy.

All things considered, therefore, I would vote for no change in policy today and for adoption of the alternative A current directive distributed by the staff. In complying with this directive, I would hope the Manager could operate in such a way as to <u>not</u> encourage, and if possible dampen, the seasonal tendencies for rising short-term rates and tightening money market conditions during the remainder of the year.

Mr. Mills made the following statement:

In my opinion, there has been no material change in economic conditions since the last meeting of the Federal Open Market Committee. The degree of credit availability now to be aimed at is the subject up for decision. For convenience, credit availability can best be defined in terms of the supply of reserves. It continues to be essential to supply reserves sufficient to foster further expansion of the economy and to meet seasonal reserve needs.

Considering the existence of latent inflationary pressures and the difficult balance of payments problem, reserves should be provided in the minimum amount necessary to accomplish the desired objective, which would envisage a level of free reserves ranging from $50 million down to zero. This reserve target would require a steady injection of reserves into the commercial banking system until year end but, although an expansion of bank credit would have been supported, the general availability of credit would have been kept relatively taut so as to discourage commercial bank lending ventures overseas and to compel their modest rationing of credit to the end of directing their lending attention into more worthwhile and constructive economic channels.

In view of the flow of repayments reaching the commercial banks on outstanding loans and investments and a capacity to rearrange their credits into a changed pattern, there is every reason to believe that the proposed policy would place no obstacle in the way of reasonable economic expansion, but in exercising a modest degree of credit restraint would be conducive to improvement in the field of commercial bank credit practices.

Mr. Mills added that his statement touched upon a predicament that he believed was increasingly faced by the Committee in developing monetary policy, and that was how to reconcile the objectives of monetary policy with the obligations that the System had to foster and maintain a sound and solvent commercial banking system. There was no desire to interfere in the bankers' individual independence in selecting loans and investments. On the other hand, monetary and credit policy involved a general credit control, and the time might come when monetary policy should be directed equally to its broader economic objectives and to the supervisory obligations that the Committee had to the banking system. For many years, Mr. Mills said, the goal of monetary policy had been to stimulate stable economic growth. Economic growth was identified, of course, with the expansion of the money supply and of bank credit. Mr. Mills was of the opinion that in the longer run there could be a conflict of interest between the economic objectives of monetary policy and its use as an agent to encourage better banking practices. In his opinion, the Committee should now move in the direction he had indicated, which would be desirable both on economic and commercial banking grounds.

Mr. Mills said that for the directive he preferred alternative B, which called for only a slight tightening of money market conditions. For the most part free reserves recently had been ranging moderately above $50 million. In his thinking, the free reserve level should be on the lower side of $50 million, and down to zero.

Mr. Wayne said the trend of Fifth District business activity had changed little in recent weeks and prospects for the near future remained good. Insured unemployment throughout the District had continued to decline about seasonally. The latest data on construction indicated some improvement in employment, building permits, and contract awards. Furniture manufacturers at the recent Southern Markets received a record volume of new orders and were now operating at 100 per cent of practical capacity to meet delivery schedules that were almost solid through March and extended as far ahead as May and June on some lines. A leading furniture producer reported small-scale introduction of a second shift to cope with a backlog that was twice as large as ever before, even though $5 to $6 million of new orders had recently been turned down. Textile output remained booked up far into the future, and recently reported third-quarter earnings for some of the nation's principal textile firms showed gains averaging nearly 50 per cent over last year's figures as a result of strong demand and the reduced cost of cotton. In the latest survey, business sentiment remained generally optimistic. Manufacturers again reported significant gains in orders, shipments, and backlogs; a few continued to report wage increases; and there were scattered references to higher prices.

Mr. Wayne said there was not much he could add to what already had been said regarding national economic conditions. He was disposed to align himself with the analyses that Messrs. Robertson and Mitchell had presented. In the policy area, some recent developments suggested that it might be desirable to reduce reserve availability for domestic reasons. Despite these considerations, however, it seemed to him that any move toward less ease would create problems. He could see no way to make any significant move toward less ease which would not create conditions requiring an increase in the discount rate which could lead to developments the Committee was not seeking at this time. If higher rates should spread through the market they would cause large shifts in assets, possibly including a substantial run-off of CD's unless the Board decided to revise Regulation Q and such shifts might have undesirable international repercussions. He was content to wait at least until the next meeting before deciding whether a policy change was necessary.

Mr. Wayne commented that there had been a good deal of discussion about the uncomfortableness of staying in one policy posture for a long time. He would like to disassociate himself from that view. He thought the policy the Committee had been following had been correct, and he was not uncomfortable about it.

Mr. Wayne concluded by saying he would prefer no change in policy and certainly no change in the discount rate. Alternative A of the draft directives was acceptable to him.

Mr. Clay said it would appear appropriate to continue the monetary policy adopted at the last meeting of the Committee. There were some special developments that underscored this policy position. One was the impact of the automobile strikes with their various repercussions upon the domestic economy. On the international scene was the British decision to maintain the current discount rate rather than increase it. This would presumably make the tightening of credit policy in this country inappropriate, quite apart from other considerations. The fact was, however, that the basic economic situation did not call for a reduction of monetary ease at this time, even aside from these special factors.

Mr. Clay remarked the domestic economy continued to be dependent for expansion primarily upon consumer and business spending. Present indications of consumer spending performance did not suggest any need to deter it. Even after allowance was made for the preliminary nature of the McGraw-Hill survey of business capital outlays, that sector did not suggest any basis for credit restraint. When account was taken of the contractive trend in residential construction in recent months, higher interest rates would not appear to be a salutary development for that sector of the economy--quite the contrary.

When one turned to manpower and the U.S. resource base, one again found a stimulative policy in order. Granted that the unemployment problem was of a somewhat special type and that it might require other measures to facilitate the upgrading of the labor force, the solution to the problem was dependent upon an expanding economy that would provide added jobs and enable the upgrading to take place.

Monetary policy should continue to pursue the expansionary role that the growing resource base and increasing productive efficiency permitted it to follow without overheating of the economy, Mr. Clay felt. Price developments thus far were not such as to justify any contraction in the general credit situation on that ground. Credit developments also appeared to be generally in line with the monetary policy to be pursued. Despite the fluctuations in credit growth over shorter periods that might raise questions as to the pace of expansion, perspective over a longer span of months and for the year to date did not suggest that the policy followed had been too expansionary.

Mr. Clay said alternative A of the staff drafts appeared to be appropriate for the economic policy directive for the period immediately ahead. In his opinion, no change should be made in the discount rate.

Mr. Scanlon reported that the level of economic activity in the Seventh District continued to rise, allowing for the effects of the General Motors strike. Retail sales in October, excluding autos, appeared to have held close to the September level in the District and were far above the relatively low year-ago level.

Output of the major industries important in the District, again excluding autos, appeared to be rising more rapidly than overall production in the nation. Delays were being reported by District producers of steel in meeting promised delivery schedules for some products. New orders for steel continued in large volume and backlogs were rising further as many manufacturers attempted to build up their inventories.

Mr. Scanlon observed that producers of industrial machinery continued to report a strong flow of new orders and further rise of backlogs. Orders were especially strong from the metalworking industries. Rising backlogs were reported also by purchasing agents in Chicago. In September, 54 per cent of those surveyed reported increased backlogs of orders, compared with 49 per cent in August.

Residential construction activity in the major District metropolitan areas had drifted downward in recent months along with the downward drift in the nation, Mr. Scanlon said. However, vacancy rates in apartments and houses available for rent or sale in the North Central region in the third quarter were below the year-ago rates and were somewhat below the comparable rates for the U.S., according to a recent survey by the Mortgage Bankers Association. Also, mortgage delinquencies in the Midwest were generally below the year-ago levels. Unless vacancy and delinquency rates were to rise appreciably from current levels, downward pressure on residential construction in the District would not be expected to be severe or of long duration.

The flow of savings to banks and savings and loan associations in the District had been relatively stronger than in the nation. While individual bankers were complaining about a decline in loan demand, October figures for weekly reporting banks in the District did not reflect the slackening that was apparent in the national data.

Business, consumer, and real estate loans all rose more than a year ago although there were substantial reductions in loans to finance companies and loans on securities. Business loan strength was evident for most industries, including the metals manufacturing firms for which the seasonal repayment was smaller than usual in October.

Mr. Scanlon observed that the basic net deficit positions of the large District banks, with one exception which dominated the total, appeared to be somewhat tighter than they were a month ago. The two major Chicago banks had added more than $150 million to their outstanding negotiable CD's in the past month and one had increased the amount of its unsecured notes outstanding.

Mr. Scanlon said his views on policy were very much like those expressed by Mr. Daane. He had the feeling that in some respects the evidence to support a firmer monetary policy was stronger at recent meetings than it was today. While he was not opposed to a slightly less easy policy, unlike Mr. Hayes he believed it was unrealistic to contemplate a short-term bill rate of 3.75 per cent without Committee members having resolved in their minds that a change should be made in the discount rate. Additionally, he disliked projecting a change in policy into the middle of a three-week period unless the Treasury calendar was restricting the Committee. Since there was no such a restriction currently, Mr. Scanlon would prefer to examine the facts at the next meeting, and, if a change was warranted, make it immediately. On this basis, he favored alternative A for a directive and he would not change the discount rate.

Mr. Deming said that an opinion survey early this month of 25 of the Ninth District's larger industrial concerns indicated continued expansion of output through October. The various statistical indicators available through September showed that industrial output in the region had expanded quite substantially since last spring. The preliminary manufacturing employment data for October tended to substantiate the opinions of industrial leaders that output continued high during the recent month. Furthermore, the survey indicated that the current favorable trend would continue through the fourth quarter.

So far this year, Mr. Deming continued, negotiated and deferred money wage increases in labor contract settlements in the Minneapolis area had averaged 9.3 cents per hour as compared with 9.1 cents last year. And information from the Associated Industries of Minneapolis, an employer association, seemed to indicate that most industries did not feel that the auto wage pattern would be carried through to them.

District bank credit expansion in October, Mr. Deming said, was much stronger than a year ago and much stronger than the average for earlier Octobers. This reflected behavior at city banks almost entirely; country bank performance was about the same as last year and about seasonal. Both loan and investment expansion at city banks contributed to bank credit strength in the month. October performance pushed bank credit growth so far this year to above last year's expansion and well above average growth. In contrast, bank deposit growth in October was weaker than a year ago and than the average growth for the month. Still, deposit growth so far this year had been quite strong, well above average and second only to the same period in 1962.

Mr. Deming said his position on policy was quite close to Mr. Daane's. He favored no change, and consequently he preferred alternative A for the directive. However, he agreed with those who would remove the constraint under which the Manager had been operating, of attempting to avoid negative free reserve figures. In his opinion it was unrealistic to expect the Manager to operate with a target of $50 million free reserves or less, and still never have a negative figure. While he would not go as far as Mr. Hayes had in calling for negative reserves more often than positive, he thought there was no reason to try to avoid negative figures altogether. He was not recommending deviations on the side of tightness, but rather a willingness to accept negative figures if they happened to occur. In his judgment it was sheer luck that free reserves had come out above zero last week. Mr. Deming favored no change in the discount rate.

Mr. Swan reported that there appeared to have been no major changes in the business picture in the Twelfth District since the last meeting of the Committee. Employment figures for October were not yet available. However, he had been reviewing the data for the first nine months of the year which showed that total employment had risen a little over 1 per cent from December 1963 to September 1964, as compared with a rise of something over 2 per cent for the country as a whole. Over-all, the District had fared rather well in view of the fact that manufacturing employment was down almost 2 per cent compared with an equivalent rise for the country as a whole. The decline in District manufacturing employment was, of course, related to the situation in the defense and space industries. The September decline in that area was the smallest month-to-month decrease so far this year. In the lumber industry there had been some pickup in new orders in recent weeks, but the period was too recent and too short to say whether this development was of any particular significance. Not surprisingly, western steel production rose substantially in the month of October.

Some of the larger District banks were in a rather tight position, Mr. Swan observed. Borrowings from the San Francisco Bank continued to be rather substantial, although this varied considerably from bank to bank. Still, loan demand did not appear to be excessive at this point. By and large, the October figures for weekly reporting banks showed smaller increases than a year ago.

Mr. Swan saw no basis at this point on which to make any change at all in policy. In fact, he said, as Mr. Daane and others had noted the case for a change perhaps was stronger at recent meetings than it was today. Without reviewing the figures in detail, the statistics for October on industrial production, inventory accumulation consumer spending, and business spending all seemed to him to reflect some moderation in the rate of expansion, although this might be related in considerable measure to the auto strike. Moderation also was reflected in the financial area, in terms of the general rates of bank credit and monetary expansion that had been experienced.

In the international area, Mr. Swan continued, the balance of payments situation was at least no worse than it had been earlier. At the moment, even a slight firming of short-term rates would appear inappropriate, in light of the problems the British were experiencing and of the steps they were taking to meet them. Moreover, he continued to have considerable doubts that the effect of a slight firming of short-term rates on capital outflows would contribute much to solution of the U.S. balance of payments problem. It seemed to him that the Committee had to face up to the question of whether much more overt action was called for now, and he did not think that such action was justified.

Mr. Swan noted that because of the current Treasury financing the Committee would have to wait a week or so in any case before implementing a policy shift. He agreed with the view that it was not desirable to make a change in policy at a point between meetings. This question had come up on another occasion recently, and the decision then had been to wait until the following meeting. He thought that was a desirable position to take again, particularly with the lack of compelling reasons to change policy at present.

Mr. Swan favored no change in policy on these several grounds. The targets he had in mind were free reserves around $50 million and a bill rate in the range 3.55 to 3.60 per cent, or perhaps up to 3.65 per cent. He agreed that if the bill rate got much above 3.65 per cent and began to approach 3.75 per cent it would cause a serious problem with respect to the discount rate, which he thought should not be changed now.

Mr. Swan said he also had been thinking about the question of negative free reserves, and was becoming increasingly doubtful that it was desirable from the point of view of either the Committee or the Manager to argue that negative figures should be avoided at all costs. He thought the objective of avoiding negative figures may have taken precedence recently over the $50 million target, and he doubted that this was desirable. While he did not think the Committee should call for negative free reserves just to indicate that it could do so, he would not be particularly concerned if a negative figure resulted by chance at a time when the target was, say, $50 million. When free reserves had risen almost to $200 million in the week including Columbus Day, it was generally understood that this was an inadvertence. A similar understanding might develop with a miss in the opposite direction.

Mr. Swan preferred alternative A for the directive. He thought the qualifying phrases attached to several statements in alternative B implied doubts and made for extremely weak language for a directive.

Mr. Irons remarked that conditions in the Eleventh District were relatively unchanged from those he had reported at the last few meetings. Minor changes had occurred, with increases and decreases about offsetting each other, and the District's economy continued to move along at a relatively high level. The General Motors strike had not affected the Eleventh District as much as some others, but it did have some effects, including cancelling out part of a slight increase in manufacturing production. Still, October probably would show a fractional production increase on a seasonally adjusted basis, and November might continue at about the same level. Construction was strong, although down a bit in October, with the greatest strength in the nonbuilding area. On a cumulative year-to-year basis, District construction activity was up about 3.2 per cent. Employment also had improved. Nonagricultural employment totals had moved up to a record level, and unemployment was running at an unadjusted rate of about 3.6 per cent.

The employment situation probably was a bit stronger than in the nation as a whole. One indication was that the Reserve Bank's Personnel Department was beginning to find it difficult to fill clerical and other vacancies; the employment agencies simply had no applicants to send over. Retail trade had been quite strong. It was up about 11 per cent from a year ago, reflecting rises not only in the large cities but also in the smaller cities. There had been no particularly significant developments in agriculture, and the situation there appeared satisfactory.

In the financial area, Mr. Irons said, District banks perhaps had become a little more liquid in the last three weeks. There was some sluggishness in loans, particularly in the commercial and industrial category, substantial purchases of Government securities, and some increase in deposits. The amount of discounting at the Reserve Bank was less, but there had been an increase in Federal funds purchases.

All in all, Mr. Irons said, from the standpoint of the District there appeared to be nothing to indicate the need for a change in the present posture of the Committee with respect to credit availability. Looking ahead to the next three weeks, it seemed to him that the choice between no change and a slight increase in firmness was becoming more difficult to make; the decision probably would have been easier three or six weeks ago than it was now. In general, he thought the alternatives the Committee was debating, between a free reserve target of $50 million or $25 million, or perhaps zero, involved differences that were so minor they might be dropped in the process of rounding. He did not think that the range of views on policy today was as wide as it might appear to be. There were arguments based on both domestic and international considerations that could be advanced on both sides of the question when considering policy alternatives that involved so small a difference. Personally, he did not think the Committee would gain much by an almost imperceptible firming, and it was possible that something might be lost. He was not ready to advocate a change in policy toward greater firmness at this meeting, although he might be at the next. Accordingly, he concluded that the Committee should continue policy about where it was.

As he had said at the previous meeting, Mr. Irons continued, he would not be particularly bothered by occasional negative free reserve figures, lasting for a few days, although he might be concerned if negative figures appeared for three successive weeks. His target for free reserves would be somewhere in the area of zero to $50 million, and usually above zero. He would be satisfied if the bill rate continued in the 3.55-3.60-3.65 per cent area, with the Federal funds rate at 3-1/2 per cent.

Mr. Irons said he favored not only no basic change in policy, but also no attempt even to shade policy slightly toward firmness. When the time came to make a change, he would be willing to advertise it to the market. He thought the Committee should have strong and convincing arguments before it changed policy, and he did not think they existed now, although they might in three or six weeks. He would not change the discount rate and would accept alternative A for the directive.

Mr. Ellis commented that New England was so dependent upon manufacturing for a livelihood that he naturally looked first to see how the factories were doing. As he had noted before, the evidence was mixed. In five of the major industries for which the Boston Bank prepared output indexes--shoes, apparel, textiles, nonelectrical machinery, and transportation equipment--the September figures registered an encouraging seasonally adjusted gain. For paper and electrical machinery, however, the trends were down enough to pull the total index down fractionally. At the same time, manufacturing employment rose minutely and insured unemployment continued its seasonal decline. By October 17, insured unemployment on a three-week average basis was running 13 per cent below year-ago levels.

Mr. Ellis said that New England manufacturers, having pretty well accomplished a 16 per cent increase in capital spending this year, now reported expectations for next year that indicated a gain of 5 per cent on the basis of previous experience with such surveys. Reinforcing this evidence of business spending were the trends in construction contract awards, which revealed a September total 24 per cent above a year ago. Perhaps New England was affected more than other areas by urban renewal programs because residential contracts in September exceeded year-ago levels by 33 per cent, bringing the total for the year to a plus 21 per cent, in contrast with the U.S. figure of a plus 3 per cent. In the financial sector, District banks were reporting continued strong loan demand.

Turning to monetary policy, Mr. Ellis said that everyone at the table had the same underlying elements in his analysis. Views on policy were matters of judgment, involving the weight to be given to the different factors. In his judgment, the economy was likely to move ahead strongly in the first half of the next year, and it would not require the additional stimulation of credit expansion at the rate that had resulted from the Committee's policy over the last three months, since the slight change made in August. Pressures for price advances were building up, and they should not be further stimulated by credit expansion at the recent rapid rate. The balance of payments deficit remained large, and outflows of funds in the form of bank loans continued excessive. The deficit had been too high for too long.

From this point of view, Mr. Ellis said, he admitted to some disappointment on noting in the "green book"[1/] that events of the past three weeks had "resulted in somewhat easier money market conditions and stronger bond markets." Looking at events since the modest policy shift in August, it seemed that the lessened ease the Committee had intended had not occurred, or at least had not retarded the subsequent rate of credit expansion. In fact, the growth rate since then had exceeded that of preceding months.

This sequence of events led Mr. Ellis to conclude that a threshold had been reached; it appeared that the rate of credit expansion could be slowed only by crossing the level of zero net free reserves. The Committee had been discussing free reserve targets close to zero, and the possibility that the zero line would be crossed inadvertently. In his opinion, the impact of crossing the zero line would be the same whether that event was inadvertent or deliberate. If the threshold was to be crossed, it could be done either in a step sufficient to clearly signal a policy move or by

1/ The "green book" to which Mr. Ellis, and subsequently others, referred is the report, "Current Economic and Financial Conditions," prepared for the Committee by the Board's staff.

a more gradual shift. His choice would be to attempt to move over the threshold gradually, seeking occasional net borrowed reserves as a deliberate policy.

Mr. Ellis agreed that no time ever seemed to be the right time to change policy. In his judgment the right time had been several weeks ago, or perhaps several months ago. He would suggest that after the Treasury financing was completed the target for free reserves be set at zero with the expectation that operations would result in figures on both sides of the line. He would expect bill rates to rise to about 3.60 per cent or a little higher; the Federal funds rate to hold firmly at 3.50 per cent or above; and member bank borrowing to hold above $350 million on the average.

Mr. Ellis commented that the second paragraph of the directive had been substantially unchanged since August and the directive as a whole contained two apparent inconsistencies. The first paragraph called for accommodating moderate growth in reserves, credit, and money, while the second paragraph called for continuing money market conditions that had proved clearly inconsistent with moderate growth. The second paragraph then repeated the instruction to accommodate moderate reserve growth. If the Committee adopted alternative A, he would hope the last clause of the second paragraph would be deleted. His own preference was for alternative B.

Mr. Balderston called the Committee's attention to the fact that for the most recent three-month period nonborrowed reserves had grown at an annual rate of 5.4 per cent and required reserves behind private demand deposits at an annual rate of 6.4 per cent. During the past two months, bank credit had increased at an annual rate of 8 per cent. It seemed to Mr. Balderston that the Committee somehow had gotten off the track of appropriate policy and was fearful of getting back on it. He submitted that it was time to adopt alternative B for the directive, and to inform the Desk clearly that free reserve figures below the zero line were permissible and were within the intent of the Committee.

Chairman Martin said he had come to this meeting convinced in his own mind, after considerable thought, that the Committee would be wise to move to a slightly less easy position. Each member had a particular set of reasons for his views on policy; he too had a variety of reasons for his conclusion, including the fact that he happened to belong to the gradualist school.

The Chairman thought the recent Administration statement regarding monetary policy and the independence of the Federal Reserve was splendid. In his opinion, recent monetary policy had, on the whole, been correct. Some would have preferred to see it firmer and some easier, but that was a matter of judgment. Now he thought the Committee had to be careful to avoid taking the position that any change in monetary policy should be delayed until there was a hemorrhage in the balance of payments, or a clear case of over-full employment, rising prices, or wage settlements getting out of hand. If the Committee waited for such developments before moving, monetary policy would bear the entire blame for events. There would be no problem if general price stability was maintained and if wage settlements were kept in line with productivity increases. But if the Committee ignored inflationary tendencies at a time when something could be done about them, it would be compounding the difficulties.

The Chairman said he was so optimistic about the domestic economic outlook that he thought a few mistakes could be made without endangering the economy. But he was deeply concerned about the international situation; Britain, in particular, was facing major problems. There had been suggestions here and abroad that selective rather than general controls should be employed in meeting balance of payments difficulties, but this sort of shift would take time and he doubted whether the western world was ready for it. He was deeply worried about the U.S. balance of payments deficit, and he became increasingly concerned when he heard statements to the effect that the deficit was "only" $2.3 billion, or efforts to explain away the last quarter's deficit, or arguments that the Committee should avoid firming actions because they might attract funds from Britain, or statements that monetary policy was not the appropriate tool for dealing with the problem and the Committee should let it be handled by other means.

Chairman Martin thought the Committee might be nearing the point where monetary policy would bow out as a flexible instrument, and criticisms to the effect that policy was continuously stimulative would become correct. One might argue that there was nothing wrong with keeping policy unchanged for long periods, but at the same time some degree of flexibility was desirable. If the Committee had moved more aggressively on August 18 and then decided that had been a mistake, it could have reversed the action. This was not possible with most other tools. If the Committee never did any shifting it would gradually get boxed into a position of doing nothing but contribute to the flow of funds, perhaps thinking that the flow of funds had more to do with the business situation than in his judgment it actually did. He thought the notion was preposterous that a change of $25 or $50 million in free reserves could make or break the economy.

Chairman Martin reiterated that he came into the meeting prepared to say that the Committee should move toward firmer conditions, and he would still be prepared to do this if he were acting on his own. It was clear from the go-around, however, that the Committee was narrowly divided on what amounted to a relatively small shift in policy. Sometimes it was necessary to make decisions on the basis of a narrow majority, but all things considered he did not think it would be desirable for the Committee to act at this time unless it was more united in its thinking. In his judgment a vote of 8-4 or 9-3 would have provided a better basis for action today than a 7-5 division. His thinking also was influenced by the fact that the Committee would have freedom to maneuver in the period ahead, and by the point that had been made regarding the disadvantages of projecting a policy change into the middle of a three-week period.

Accordingly, the Chairman said, he would cast his vote for no change in policy today and for alternative A of the directive. If a majority of the Committee voted in this way, he would suggest that the members study the matter thoroughly between now and the next meeting. In the meantime, he would have an opportunity to discuss the situation with the Secretary of the Treasury.

Mr. Shepardson said that reference had been made in the reports to the fact that the market generally had firmed up somewhat recently because of a general belief that the System was not going to move in the direction of further tightening. It seemed to him as long as there had been uncertainty on this score the uncertainty itself might have had some restraining influence. He thought it was unfortunate if the prevailing opinion was that there would be no change in policy. It had been suggested that within a general posture of no change in policy the Committee should accept a broader range of variation in free reserves, with negative figures from time to time; i.e., to broaden the range within which the Desk would operate. This would have the advantage of reinstating at least some of the uncertainty.

Chairman Martin commented that there was another question that he thought the Committee should face up to. In his opinion he and some other members, including Mr. Mitchell, had been doing too much commenting on monetary policy in public. He thought that was bad for the System. He did not think it was necessary to censor speeches, and he was called upon from time to time to comment on policy, as were other members. But he disliked the thought that the market might know pretty well what was going on at the meeting today. In his opinion Committee members ought to hold their discussions in the meeting room and not make specific statements about monetary policy outside, certainly not immediately before a meeting.

Mr. Mitchell said that he did not take umbrage at the Chairman's remarks; he felt much the same way. However, he felt the position he happened to hold was one that did not have much chance of being enunciated. He had thought it particularly important to express that position because the New York Bank, whose President held a contrary position, was so powerful in molding public opinion through its daily access to the press. As a consequence he did not think the public got a well-rounded view of the thinking of Committee members.

Mr. Mitchell added that he would like to comment on the subject of free reserves. At the time last summer when he had been concerned with the need for avoiding negative figures the situation in the bond market had been extremely delicate, and he had been apprehensive that the market would react strongly to any signal of a possible change in policy. Those conditions did not exist today, and he thought that free reserves could occasionally be negative without any serious consequences.

Mr. Daane said he shared the views on free reserves that Mr. Swan and Mr. Deming had expressed. In the last statement week, when free reserves came out to $5 million, the Manager had been extremely concerned that they might turn out to be negative, even though the difference between plus or minus $5 million free reserves was absolutely nil in terms of real effects. He would have no quarrel with occasional negative figures if they arose in the context of no change in policy and a target of $50 million.

Mr. Swan commented that it was one thing to specify a target and recognize that it might be missed by a considerable margin. This was acceptable to him. It was quite another matter, however, to say that one had a wider range in mind and didn't care if the outcome was plus or minus $50 million. He would not approve of such a position.

Mr. Hayes said that he would plead guilty along with others of having permitted his feelings on policy objectives to have colored his speeches to some extent from time to time. But he wanted to dis-associate himself strongly from the notion that he had daily contact with the press. He hardly ever saw the press, and, of course, those working at the Desk never saw the press at all. Furthermore, Mr. Waage, the press officer at the Bank, never gave any indications on policy to the press. In his opinion, most clues to the Committee's current policy posture originated in Washington.

Chairman Martin commented that he thought all members of the Committee could plead guilty; he realized that they all were invited to make speeches. He had had no particular objections to Mr. Mitchell's speech, but he had thought the timing, on the Sunday before a meeting, had been unfortunate. He had received a number of calls from people asking whether he knew that Mr. Mitchell had already taken a position on policy before the meeting. It was important for the members to bear in mind that there was a timing problem. He personally had refused a great many invitations to speak during the election campaign and immediately after it, accepting only those in which he could discuss the Federal Reserve as an institution with no implications for current policy. Members of Congressional committees, noting that Committee members were talking about policy in public, could justly ask why they should not have the minutes currently and serially if members of the Committee were publicly discussing impending policy determinations.

Thereupon, the meeting recessed and reconvened at 2:00 p.m. with the same attendance.

Mr. Stone referred to the earlier discussion of the possibility of net borrowed reserves and said he would like to indicate one type of situation that could arise at the Desk. Suppose the projected free reserve figure for a statement week was $50 million as of a Tuesday night, but on Wednesday morning the projection was revised down to, say, $10 or $15 million, perhaps because float had collapsed overnight or required reserves had risen sharply. To bring the week's figure back up to $50 million would require bill purchases of $250 or $300 million on that Wednesday. Perhaps a bulge in free reserves was projected for the next day, and it had been planned to make substantial bill sales. If the purchases were made on Wednesday, the volume of subsequent sales would be increased. But if no action was taken in light of the Wednesday estimate of $10 or $15 million, the figure published for that week might well turn out negative. This kind of situation was not uncommon: how would the Committee propose that he deal with it?

Mr. Robertson asked how the Manager would proceed in the reverse situation, with the projected level of free reserves revised upward on a Wednesday morning preceding a week in which substantial purchases were expected to be necessary. Mr. Stone replied that he would not sell bills on that Wednesday if it would be necessary to buy them back the next day, because he thought the Committee did not have the same inhibitions about upward deviations from target levels as downward. Mr. Robertson rejoined that in his judgment the same principle should be applied in the type of case Mr. Stone had described.

Mr. Deane agreed, and commented that the situation Mr. Stone had described seemed to him to be precisely the type of case Committee members had in mind today in suggesting removal of the constraint on operations posed by the effort to never show negative figures. If the figure for the first week did turn out negative, however, he would urge that the Desk get a running start to ensure a positive figure for the next week to avoid two consecutive weeks of net borrowed reserves. Also, it was of some importance how the press officer of the New York Bank treated the negative figure in the course of the press conference; there would be little problem if it was made clear that the negative figure had represented a miss.

Mr. Robertson said he questioned whether attempts should be made to explain away figures even if they had come about inadvertently; it would be better, in his judgment, to let the results of actions stand without comment.

Mr. Hayes observed that he had great sympathy for this view. He noted that on several occasions, in presenting these figures to the public, the Bank's press officers had stressed the volatility of the numbers and had sought to de-emphasize the significance of week-to-week results. Mr. Wayne also agreed, observing that when a particular outcome was described as an error the outcome sought was identified by implication.

Chairman Martin also concurred in this view, noting that he frequently was asked by people who saw explanations of policy in the press why the Committee did not announce its policy decisions as they were taken. In his judgment, some types of decisions on monetary policy had to be kept confidential if operations were to be effective.

Mr. Shepardson referred to the illustrative case Mr. Stone had described, and said he agreed it would be a mistake to undertake operations on a Wednesday to meet a free reserve target when they would have to be reversed on the following day. He thought, however, that it would be just as much of a mistake to lean towards erring in one direction in a statement week if there had been an error in the other direction in the preceding week. In his opinion, deviations from the target should be accepted as they developed without actions to offset them later. In effect, the Committee should be prepared to accept any outcomes within a certain range of deviation from the central target as being "on track." The problem up to now had resulted from the effort to ensure that the figures would always fall on one side of the zero line. Mr. Hayes added that any realistic range of acceptable results had to be relatively broad.

Chairman Martin then suggested that the Committee vote on the alternatives of no change in policy or slightly less ease for the next three weeks, and on the corresponding alternatives for the directive, although the specific language of the directive approved would be subject to modification. Mr. Shepardson said his vote would depend on whether a decision to make no change in policy would indicate acceptance of the possibility that free reserve figures might swing on both sides of the target even if it meant negative free reserves at times, and he asked for clarification on this point. Chairman Martin said he thought it was clear from the discussion today that almost everyone was willing to accept that possibility.

The poll of the members indicated that all except Mr. Hayes favored no change in policy.

Thereupon, upon motion duly made and seconded, and with Mr. Hayes dissenting, 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 apparent underlying strength in current economic conditions, apart from the effects of work stoppages in the automobile industry; indications that the rate of increase in business capital spending may moderate in the coming year; relative stability in broad commodity price averages, even though additional price increases have occurred in some materials markets; and the recent reduction in bank credit and monetary expansion from the high rates of summer. It also gives consideration to the persistence of a sizable deficit in the U.S. balance of payments.

To implement this policy, and taking into account the current 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.

In explaining the reasons for his dissent, Mr. Hayes said he was impressed by the facts that there seemed never to be a right time to make a difficult decision, and that the need for maintaining an even keel during Treasury financings inhibited action by the Committee much of the time. He felt that some move in the direction of firming had been indicated for quite a while on the grounds of the balance of payments. Also, he thought there was a danger of the Committee's being overly concerned about the state of the bond market. It naturally was interested in the state of this market, but it should not let that interest inhibit appropriate policy moves. Nor did he think it should be prevented from taking sound policy actions by the fact that those actions might create complications under Regulation Q. Finally, Mr. Hayes said, he would dissent from the fears that the Committee would be creating problems abroad by a gradual move in the direction of somewhat less ease.

He was sympathetic with the Chairman's comment that there was some danger that monetary policy would be abandoned as a means of achieving equilibrium in the world and he was alarmed at the tendency, visible on both sides of the Atlantic, to favor use of selective measures. This tendency threatened destruction of the existing international financial system. While he agreed that this was not the only time at which the Committee could act, on balance he favored a move toward greater restraint now.

Chairman Martin commented that he thought it quite proper for anyone who felt as Mr. Hayes did to dissent. He was sympathetic to everything Mr. Hayes had said, but in view of the considerations he had outlined earlier he still favored no change in policy today.

Mr. Balderston said he felt that a gradual change in policy was overdue, and his original preferences had been for alternative B for the directive, a central target of zero for free reserves, and no restraint on the range of free reserve fluctuations. He also was concerned, however, about the Committee's making a decision on these lines by a very narrow majority at this time. Accordingly, in view of the fact that the Committee would have a further opportunity to grapple with the problem at its next meeting, he was willing to cast his vote for alternative A.

Mr. Hickman said that he also was willing to join the majority despite the feeling he had indicated earlier that a little less ease would be appropriate now. Mr. Shepardson commented that he had voted for alternative A, although with some reluctance, for the reasons Mr. Balderston had outlined.

Mr. Shuford commented that his earlier statement had indicated that he had favored a little less ease than existed at present. This was the first time he had advocated moving in the direction of firmer conditions since the August action of the Committee, although for several months he had been concerned with the unusually high growth rates of reserves, money, and bank credit. Although he was pleased to see the slight reduction in these growth rates evident in the most recent figures, he continued to be concerned on this score. He recognized, however, that there was a problem of timing, and he could not be certain this was the appropriate time to change policy, although obviously he had thought that it was when he had made his initial statement today. In view of the considerations advanced by the Chairman and by Mr. Balderston, he was willing to wait until the next meeting of the Committee to review the question again. He could not, of course, say now what his position would be then. In a final remark, Mr. Shuford said he agreed with Mr. Ellis that the directive contained inconsistencies.

Chairman Martin then noted that the Committee had planned to deliberate the language of a trial directive today, and he invited Mr. Mitchell to open the discussion. Mr. Mitchell said he thought the Committee might simply proceed to consider the language of the draft the staff had prepared on a paragraph-by-paragraph basis, to determine how well it reflected economic and financial developments and how adequate the accompanying analysis was. He proposed that the Committee start with the first paragraph of element 1.

Mr. Wayne said that while the draft might well represent a fair analysis he questioned whether it belonged in the directive. Mr. Daane agreed, observing that elements 1 and 2 appeared to be simply a condensation of the green book and its supplement.

Mr. Mitchell said that as he viewed the matter the Committee had decided today to make no change in policy, and the draft of the first two elements could be considered to provide the economic and financial analysis which supported that decision. If the Committee felt the analysis did not support the decision, it should change one or the other. The green book gave the Committee the detailed facts on the economic situation but it did not attempt to relate these facts to the decision on policy. Since the statement in the trial directive was intended to explain the policy action, it was equivalent to the present policy record entries.

Mr. Hayes said that in his opinion element 1 of the draft was essentially a collection of facts relating to the business situation rather than an analysis of the reasons for the policy action. If the Committee wanted an analytical interpretation, the text would have to include much more in the way of evaluation and forecasting, and would have to provide the Committee's reasons for expecting certain effects or the lack of them. He thought a purely statistical compilation such as this offered a less lucid explanation than did the present policy record, which at least summarized the views on policy expressed at the meeting. There was very little in the draft in the way of weighing one factor against the other. He had never thought such evaluative material had a place in the directive but if the Committee decided that it did it would not accomplish its end with a text such as that before it.

Mr. Mitchell observed that the objective of today's discussion, as he understood it, was to see how the draft could be improved, and he hoped Mr. Hayes would have specific suggestions for its improvement.

Mr. Shepardson said that at one time the policy record could have been described as a statement prepared at the Board at the end of the year, but this was no longer true. The staff was now preparing the entry for each meeting on a current basis, with the benefit of having heard the discussion around the table and of the minute record. What the Committee needed, in his judgment, was a statement on the analysis underlying the policy decision taken at each meeting. This was accomplished in the present policy record entries in a better manner, he thought, than it would be in documents like the trial directive.

Chairman Martin commented that there was a great deal of merit in Mr. Shepardson's argument, and Mr. Wayne said that it described his position exactly.

Mr. Swan remarked that he was not sure how the argument that the Committee did not need to adopt a text like that of elements 1 and 2 in light of the policy record could be reconciled with the kind of language that was incorporated in the first paragraph of the present directive. Was it proposed also to dispense with this paragraph? One reason elements 1 and 2 had been suggested was the feeling that the content of the present first paragraph needed elaboration; that a better statement was required of the considerations underlying policy than was possible in a short directive.

Mr. Shepardson said he agreed a case could be made that the present first paragraph was not satisfactory. But he thought the problem was that it went too far in attempting to describe the basis for the policy action. He would prefer a directive that dealt with the broad, continuing objectives of policy in the first paragraph, and that specified short-run operating instructions in the second paragraph. The policy record entry, which now was prepared at the close of the debate, should be relied on to report the basis for the decision taken at the meeting. He did not favor attempting to set out the economic background for the policy action in the directive itself.

Mr. Ellis said that it might be useful to recall some of the background of the proposals for elements 1 and 2. It had seemed to Mr. Mitchell, Mr. Swan, and himself from the beginning of their discussions that it would be appropriate for the Committee at some point to adopt formally an expression of the reasoning underlying its policy decision at each meeting. This was not done formally at present; the staff now prepared a summary of the meeting in the form of a draft policy record entry and submitted it to those who had been in attendance, of whom some offered suggestions for revision but most did not. It had been suggested originally that such a statement be made a part of the directive, and later an alternative proposal had been advanced that the statement be kept separate from the directive but still be formally adopted by the Committee. Mr. Mitchell, Mr. Swan, and he did not feel strongly on the question of whether the statement should be part of the directive. But it did seem logically desirable that a complete statement be adopted formally, first covering the basis for the policy action along the lines of elements 1 and 2, and then proceeding to describe the Committee's policy intent and operating instructions, as in elements 3 and 4.

As far as he was personally concerned, the most important topics on the agenda for today's discussion were elements 3 and 4.

Mr. Shepardson said he thought Mr. Ellis had raised a valid point in noting that at present the Committee did not take formal action on the policy record entry. The material in the entry provided the basis on which the Committee arrived at its decision and in his opinion it was not practical to draft it in advance of the meeting. However, he thought it would be appropriate for the Committee to make it a regular order of business at each meeting to approve the policy record entry prepared for the preceding meeting.

Mr. Daane said he subscribed entirely to this proposal. In connection with the draft entry that had been prepared for the August 18 meeting, for example, he felt it would have been desirable for the Committee to have reviewed it at the very next meeting. These entries might be brought up for consideration at the outset of the meeting, along with the minutes. Because the Committee was not releasing its current minutes, the policy record entries appearing in the Board's Annual Report provided the main medium for communicating the Committee's reasoning to the public.

Chairman Martin said that if the Committee waited three weeks to review material for official approval it was possible that reactions might be affected by any changes in thinking over that period. Also, if someone was absent at the following meeting the benefit of his comments would be lost. In his opinion, the people at a meeting ought not to be revising the views they had expressed in the past, however unsound they may have been.

Mr. Hayes suggested that anyone absent at the meeting could convey his views to the Secretary. Chairman Martin commented that this still would not meet the problem that one's thinking might change quite a bit over a three-week period.

Mr. Wayne said he agreed that views could change. However, he always had tried to evaluate the draft policy record entries as objectively as possible, in terms of whether they reflected accurately views of the majority as expressed at the meeting. In general, he thought the policy record entries presented the basis for the decisions of the majority quite well.

Mr. Mitchell said that the Committee members' review of the draft policy record entries inevitably were affected by the lapse of time; one had to try to recreate the environment of a meeting. At the moment, both he and Mr. Daane were still in process of commenting on the August 18 entry. He thought Mr. Shepardson's suggestion that the Committee could adopt a policy record entry three weeks after the meeting was unrealistic. But in any case this suggestion was not related to the real issue with respect to elements 1 and 2. These elements had been proposed in the belief that the Committee should decide in the course of the meeting on the basis for whatever policy decision it reached. If it found it had difficulty in reaching agreement it should be prepared to spend whatever time was necessary to work the matter out. This would result in a clear record of the reasons for the policy actions, including statements of any dissents. As far as incorporating these elements in the directive was concerned, Mr. Ellis already had noted that this issue was not important, so long as the Committee formally approved a statement of the reasons for its decision at the meeting.

Mr. Daane thought the procedure proposed would be more cumbersome than the alternative procedure of having the policy record entry prepared immediately after the meeting and then reviewing it at the next meeting. So that no one would underestimate the problem he would note that the draft policy record entry for August 18 implied that those who voted against the action taken felt that monetary policy had nothing to offer with respect to the balance of payments. He had been in the minority then, and he certainly had never felt this. This was the kind of thing that ought to be looked at by everyone.

Mr. Brill said he would like to clarify one point about the staff draft of the trial directive. The staff had interpreted its assignment as calling for the preparation of a text for elements 1 and 2 that would explain the policy position and action described in elements 3 and 4. If the draft seemed more factual than analytical this partly reflected the effort to incorporate in element 2 facts concerning, for example, recent growth rates in reserves and deposits that were necessary to make the element 3 statement of policy intent meaningful--facts that might or might not seem analytically important in themselves. With respect to elements 1 and 2 as a whole, there was no intention to make them absolutely complete, but rather to emphasize the main points of significance. It would be preferable, of course, to prepare alternative drafts of the trial directive, as often was done for the regular directive, but this might prove to be a formidable task, given the timing with which important data become available.

Mr. Hayes said that the Committee seemed to be on the horns of a dilemma. On the one hand, it could ask for a factual statement, and the draft did appear to be a good summary of the green book. But such a summary did not explain how the Committee had arrived at its decision, and he did not see what function it would serve. Alternatively, it could attempt to develop a more complete analytical statement. But he thought it was wishful thinking to imagine that the Committee could agree on a detailed analysis, since it was quite clear from the discussion at each meeting there were many variations in the analyses of members. It was difficult enough to reach agreement on a relatively brief and simple statement; to attempt to arrive at a consensus on the kind of statement proposed was a completely hopeless task, in his judgment.

Mr. Daane said he would illustrate the problem with a statement from the first paragraph of the draft, which said "no improvement had been achieved in the employment situation." To his mind, there had been improvement.

Mr. Mitchell agreed that this sentence was too bald as written. In his opinion, however, that was exactly the kind of issue the Committee should be debating, and the process of considering such draft material would provide a focus for such debates.

Mr. Deming said it was his understanding that the policy record entries were written on the basis of the minutes. Committee members had an opportunity to make suggestions on the drafts, and account was taken of these suggestions in revising the entries. These reviews did not occur so much after the fact as had been implied; Committee members received the draft entries reasonably promptly after the meetings and returned them to the Secretariat reasonably promptly. The material in the trial directives seemed to provide a good running start on drafting the entries, and he had no objections to them on that basis. But if the Committee was going to use such material for the entry itself or was going to incorporate it in the directive--and he thought it was too long for the latter purpose--there were many statements that he would want to revise. As examples, he cited the statements on capital spending plans and on the balance of payments.

Mr. Mitchell said he thought the fact that Mr. Deming also objected to some statements in the draft pointed up the need for the Committee to discuss such issues before reaching its decision on policy. If the Committee took these issues up one by one after the go-around some light would be shed on them, and members would have a better opportunity to affect each others' views. This sort of thing was now missing from the deliberations of the Committee; it was not spending enough time on its principal business.

Mr. Hayes commented that all the members were exposed to the facts in the course of briefing sessions at the Banks and the Board, and in the go-around each stressed the facts he considered most important, putting different shades of emphasis on different aspects of current conditions. He did not think the exchange of views at present was inadequate. But he did think it was fanciful to imagine that somehow the Committee could hammer out a uniform view on all points.

Mr. Mitchell replied that he was not arguing for development of a uniform view; differences in views among Committee members were important, and should appear in the record. Mr. Daane commented that one difficulty was that the trial directive necessarily would be prepared in advance of the meeting, before the views of Committee members were known.

Chairman Martin remarked that the Committee's procedure at meetings, in which each person was called on to speak in turn, might have become stereotyped. Perhaps it would be desirable to consider an alternative arrangement, under which members would be asked to address themselves to a list of topics prepared in advance. At present, each Reserve Bank President first discussed developments in his District. While District developments were interesting and important, the length of time now spent on them might be detracting somewhat from the discussion of the basic problems of unemployment, wages, prices, the balance of payments, and so forth. These problems were at the heart of the matters with which the Committee was concerned, and it might be able to deliberate them better under the alternative procedure.

Mr. Ellis said he thought the Chairman had identified, in another way, the problem with which he and Messrs. Mitchell and Swan had been concerned. What they were driving at in the proposals for elements 1 and 2 could be thought of as an agenda of key topics. Committee members could review the staff draft of these elements before the meeting, determine their points of agreement and disagreement, and come to the meeting prepared to discuss these points. This discussion logically would lead up to a policy conclusion. What was important was that there be a discussion of the bases for decision before the Committee turned to the kinds of issues covered in elements 3 and 4; just how this was achieved was not of real importance.

Mr. Wayne observed that the Committee had adopted the present pattern for its meetings nearly a decade ago, when the executive committee was abolished and the number of full Committee meetings each year was increased from four to about eighteen. He thought the Chairman's suggestion that the procedure now be changed was a good one. He proposed an experiment under which each President would concentrate on policy in his remarks, and would refer to developments in his District only to the extent that they were pertinent to his views on policy.

Mr. Hayes said he would hope that the Committee would still get the benefit of advice on any important developments in the various Districts. He would consider it quite unfortunate for the Committee to give up reports on business and credit developments around the country, which he thought were one of the elements of the Committee's strength.

Chairman Martin said he thought the Committee had made some progress today. It was obvious that three or four hours would hardly be enough to discuss the question, and the Committee might plan on continuing the discussion at the next meeting. It would be desirable, in his opinion, to have an agenda of key issues prepared, and seek to get a better concentration on these issues in the discussion. This was a prerequisite to developing an amplified statement of policy intent and instructions. He thought the Committee had to try to explain better than it had in the past what the basis of its thinking was.

Mr. Hayes said he thought the memorandum on the directive proposals that Mr. Robertson had distributed after the previous meeting was excellent. Mr. Robertson had noted that the Committee had "tended to confuse the kind of analysis that is appropriate to Committee judgments about bank credit and money with what is appropriate for inclusion in a directive that is eventually to be published and that is to reflect the views of a large deliberative body." In his (Mr. Hayes') opinion, there was a real difference between what the Committee should publicize and what it did in clarifying its own thinking, and the two should be carefully distinguished.

Chairman Martin said that any material published by the System should reflect the System's thinking accurately, and should not attempt to rationalize actions. It was vital to preserve the integrity of the System's public statements, and the Committee should attempt to be completely objective.

Mr. Hayes said his point was that the Committee could well afford to debate the issues around the table and that a give and take analysis of developments was all to the good, but he was dubious about the proposal to develop a consensus on analysis. To try to draw together in one statement the Committee's judgments on this score would, in his opinion, lead to more trouble than the Committee had now. He could not conceive of a successful effort to agree on all points when the Committee could not even agree, for example, on the extent to which there currently was a wage-price push.

Mr. Wayne commented that he thought the policy record entries had been improved over the last twelve months. He still favored releasing these entries or something similar every three months, after allowing for an appropriate time lapse. He was inclined to think that the Committee, acting as a Committee, should approve the entries. However, he thought the proposal to hammer out elements 1 and 2 at the meetings was impractical. The content of elements 3 and 4 was, of course, another matter.

Mr. Shepardson suggested that the Committee try to accelerate drafting of the policy record entries and simultaneously urge members to send in their comments as expeditiously as possible. The entry might then be put on the agenda at the following meeting for debate and adoption along with the minutes, as Mr. Daane had suggested. This would represent progress. Some lag was inevitable, but the lag would have been reduced as much as possible.

Mr. Mitchell said he would reiterate that he thought Mr. Shepardson's proposal was somewhat unrealistic. It put the Secretariat in a difficult position. They wanted to produce a policy record entry that satisfied everyone, and the result was to dilute its character and make it rather bland. Many times the Committee had not resolved differences of opinion at meetings, and the entries for those meetings consequently made a poor record of the discussion. He was not being critical of the Secretariat; in his opinion they did a good job under the circumstances. But he thought that in the nature of the case the record would be much sharper if the Committee itself agreed upon it at the meeting.

Mr. Shepardson said he agreed that there was a tendency to develop a compromise version of the record that omitted some differences in view. He thought that might be corrected by instructing the Secretariat to develop more fully the statements of differences in view.

Mr. Sherman said he did not know what to make of Mr. Mitchell's remark that the staff wrote the policy record to satisfy everyone. Over the years, the entries had been prepared on the basis of the discussions at the meetings as set forth in the minutes, with a view to identifying each policy action and giving an accurate report of the reasoning leading to it. The sole aim was to prepare entries that correctly reflected what had taken place at the meeting.

Mr. Mitchell remarked that one of the difficulties with the Committee's public relations posture was that outsiders were not sure that account was taken of all important problems in the delibera-tions. If it could be shown in the policy record that these problems were considered--whatever response the Committee made to them--that would contribute to a better understanding of what the monetary authorities were trying to do. He was not apprehensive about having a policy record that showed differences of opinion and different shadings of view.

Chairman Martin observed that Mr. Daane had raised a good point with regard to the statement in the trial directive on unemployment; this was a matter that usefully could be discussed further. He also agreed that it would be desirable to report any differences of view in the record. He thought that some people were of the opinion that the Committee was not well informed. That view may have been built up deliberately by hostile critics, but nevertheless he thought it was necessary to improve the public record on the Committee's thinking.

Mr. Hayes commented that no matter how much the record was improved the Committee still would be subject to such criticism.

Mr. Mills said he believed the Committee flattered itself by thinking that the audience deeply concerned in what it had to say and in what it did was more than a very narrow and academic one. He also thought that the more the Committee put on paper in the policy record, the more it was exposed to criticism of omission of essential material. He always had felt that the Committee members adequately addressed themselves to the main economic issues that had been abundantly revealed through various briefing sessions, the green book, and the oral reports of staff members at its meetings and, therefore, there was no reason for splitting hairs on what should be the content of an unnecessarily elaborated policy record.

Mr. Scanlon commented that originally he had approached the directive proposals with misgivings. But as he considered them further he had come to feel that since the Committee made policy changes only on the basis of what it thought were solid reasons, it certainly should be able to agree on the nature of those reasons. While this might be a difficult job, the Committee really would not have any agreement at all if it lacked agreement on the reasons for its actions. The discussion today seemed to indicate that Committee members may not have been in agreement when they thought they were. It seemed to him desirable for the Committee to do whatever was necessary to develop agreement by a majority. Not everyone, of course, had to share the majority's views.

Mr. Balderston said he felt so appreciative of the labors of Messrs. Ellis, Mitchell, and Swan on the subject of the directive that he hoped the Committee would not throw the baby out with the bath water. What seemed vital to him was that the Committee retain elements 3 and 4 in some form. As for elements 1 and 2, the alternative suggestion had been made that the green book could be released immediately after the meetings. This was a document of which, he thought, the Committee could be proud. Not that everyone agreed with everything in it; he often had quarrels with the document at a half dozen points. Perhaps the initial discussions at meetings might center on the contents of the green book, with members indicating any points at which they held differing views. When the book was published such differences in view could be shown in footnotes. After considering the green book, the Committee might discuss elements 3 and 4. He thought these elements should be saved because it was important that the Committee make itself better understood on the subjects to which they related.

Mr. Ellis referred to Mr. Hayes' statement that it was impossible to achieve a single statement of Committee views. But, he said, this was what the Committee now was doing in the policy record, except that the record was published without action on it by the Committee as such. The object of Mr. Balderston's suggestion that the green book serve as a basis for discussion seemed to him to be essentially the same as the object of the proposal that drafts of elements 1 and 2 be used in this way, since these elements were an analytical summary of the contents of the green book. He thought these elements would provide a splendid basis on which the Committee could organize its discussion, whether they were called an agenda or something else. With reference to the suggestion for publishing the green book, he would like to hear the staff's views, but in his judgment to change the character of the green book to make it suitable for publication would destroy its unique usefulness.

Mr. Robertson said that there would be no surer way of reducing the usefulness of the green book to the Committee than by publishing it. With the prospect of publication, the staff would no longer call the shots as it saw them.

Mr. Young commented that publishing the green book might make it as hard to produce as a leading article for the Federal Reserve Bulletin. Mr. Brill agreed, and added that he and other staff members had rather strong feelings on this matter. The staff viewed the green book as a confidential report to the Committee--as an interpretative document in which it could assess the economic situation candidly and could use whatever information became available, including confidential data. He thought it highly desirable to maintain the green book's status as an intimate staff communication to the Committee rather than to convert it into a document that could be released to the public. The latter course would lead to discussion of its contents in the press, to attempts to drive a wedge between staff and Committee views, and to the drying up of important sources of information. The staff considered confidentiality so important to the usefulness of the green book that it tried to keep it out of circulation even within the Government. In sum, he thought that the value of the green book to the Committee would be seriously impaired if it were made public.

Chairman Martin remarked that Mr. Brill had made a valid point. Continuing, the Chairman said he thought today's discussion had been particularly valuable because Committee members had spoken so frankly. He did not think the Committee should let this matter drop, and he suggested further discussion at the next meeting after conclusion of the regular agenda.

Mr. Swan said that today's discussion obviously had been necessary, and he was sorry it had not taken place earlier. Some members thought the Committee could not agree on language in the proposed new type of directive, and others believed that it could. He suggested that the Committee plan at its next meeting actually to go through the process of deliberating the trial directive to discover whether agreement was possible.

Chairman Martin agreed. He made the further suggestion that each member review the trial directive that had been prepared for today's meeting and plan on indicating his points of disagreement with it at the next meeting, along with making any comments he might have on the new trial directive that would be prepared for that meeting.

Mr. Mitchell suggested that the members make such comments on today's trial directive in writing and mail them to the Secretariat within the next week. The staff might be asked to distribute a summary of these comments before the next meeting. It also would find them valuable in drafting the next trial directive. He assumed most comments would be on elements 1 and 2, but some also might be made on elements 3 and 4.

It was agreed that the next meeting of the Committee would be held on Tuesday, December 1, 1964, at 9:30 a.m.

Thereupon, the meeting adjourned.

Ralph A. Young

Secretary

Attachment A

CONFIDENTIAL (FR)

November 9, 1964

Draft language for current economic policy directive for consideration by the Federal Open Market Committee at its meeting on November 10, 1964

Alternative A

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 apparent underlying strength in current economic conditions, apart from the effects of work stoppages in the automobile industry; indications that the rate of increase in business capital spending may moderate in the coming year; relative stability in broad commodity price averages, even though additional price increases have occurred in some materials markets; and the recent reduction in bank credit and monetary expansion from the high rates of summer. It also gives consideration to the persistence of a sizable deficit in the U.S. balance of payments.

To implement this policy, and taking into account the current 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.

Alternative B

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 without inflation, while placing somewhat greater emphasis on fostering improvement in the capital account of U.S. international payments. This policy takes into account the underlying strength in economic conditions, apart from the effects of work stoppages in the automobile industry; persistent advances in some materials prices, which have not, however, been reflected in the broad commodity price averages; and the vigorous although recently somewhat reduced rates of expansion in bank credit and the money supply. It also gives consideration to the persistence of a sizable deficit in the U.S. balance of payments and the possibility of some adverse effects on the deficit of the recent slowing down of economic activity in Europe.

To implement this policy, System open market operations shall be conducted with a view to achieving slightly firmer con-ditions in the money market than have prevailed in recent weeks /, while accommodating moderate expansion in aggregate bank reserves/.