

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, August 21, 1962, at 10:00 a.m.

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

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

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

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

Mr. Molony, Assistant to the Board of Governors
Mr. Cardon, Legislative Counsel, Board of
Governors
Mr. Knipe, Consultant to the Chairman, Board of
Governors
Mr. Broida, Economist, Government Finance
Section, Board of Governors

Messrs. Latham and Francis, First Vice Presidents
of the Federal Reserve Banks of Boston and
St. Louis, respectively

Messrs. Ratchford, Baughman, Jones, Tow, and
Coldwell, Vice Presidents of the Federal
Reserve Banks of Richmond, Chicago, St. Louis,
Kansas City, and Dallas, respectively

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Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston
Mr. Cooper, Manager, Securities Department, Federal Reserve Bank of New York

There had been distributed to the Committee preliminary and revised drafts of minutes for the meeting of the Committee on July 31, 1962.

A suggestion was made for a minor change in the last sentence on page 33 of the revised draft, and agreement was expressed with this suggestion.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on July 31, 1962, were approved.

Before this meeting there had been distributed to the members of the Committee a report on open market operations in United States Government securities covering the period July 31 through August 15, 1962, and a supplementary report covering the period August 16 through August 20, 1962. Copies of both reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Stone made the following comments:

Perhaps the most noteworthy change in the market during the past three weeks has been the shift in the atmosphere of the capital market. Around the time of the last meeting, and for some weeks preceding it, the view was widely held that an early tax cut was a real possibility and that the market, which was already anticipating a budgetary deficit of sizeable dimensions, would be called upon to absorb an additional \$6-\$7 billion of new debt. This prospect was a major factor in the upward movement of intermediate- and long-term rates that occurred in late June and July; and the fading of that prospect, which was well

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under way even before the President's speech a week ago yesterday, has been a major factor in the recent decline in such rates. A few developments in the corporate market will illustrate the extent of the downward rate movement. The Southwestern Bell Telephone issue, rated Aaa, came out on August 7 at a 4.45 per cent yield; a single A-rated utility issue came out a week later at the same yield; distribution of two Aaa-rated issues that had been in syndicate for some time at yields of 4.30 and 4.33 per cent has picked up sharply; and last Tuesday underwriters were sufficiently encouraged to offer a Aaa-rated utility issue at 4.27 per cent. Investors, however, are resisting that rate. Meanwhile, the new Treasury 4-1/4 per cent bond, which was offered at 101 to yield 4.19 per cent at the time of the last meeting, traded yesterday at 102-14/32 to yield about 4.09 per cent.

There has been a good deal of discussion as to why the initial response to the 4-1/4 per cent bond was so sluggish. Our conversations with the market suggest that the major difficulties were insufficient time for investors' decisions to be processed and an inadequate yield in comparison with available alternatives in the corporate market. Ours is only one of a number of post-mortems being held on that experience, and it may be hoped that out of all the discussion on the 4-1/4's will come some suggestions useful to the Treasury in future financing operations.

I should mention that conditions in the short-term market were generally steady during the period. Three-month bill rates fluctuated in the 2.80-2.90 per cent range, while the six-month issue moved generally between 2.98 per cent and 3.05 per cent. Rates on Federal funds were consistently at 2-3/4 or 3 per cent, with a substantial flow of funds apparently occurring at those rates.

Turning to Treasury financing over the weeks ahead, the Treasury is seriously considering taking advantage of the current favorable market by making an advance refunding offer shortly after Labor Day. This refunding, if it occurs, will be followed in late September by an offering for cash to meet the Treasury's early October needs. The amount of that financing will of course depend on whether the Treasury continues to add to the supply of bills in the regular weekly auctions. If the Treasury adds \$100 to next week's issue, as it presumably will, the recent round of additions to the bill cycle will be completed. No decision has yet been made as to what will be done about the bills beyond next week.

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Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities during the period July 31 through August 20, 1962, were approved, ratified, and confirmed.

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

The favorable information that has become available since the last meeting, most of which related to the performance of the economy in July, has largely offset, both numerically and psychologically, the effect of the depressing figures for May and June. Most favorable were the larger than expected increase in industrial production and the sharp rebound in new orders for durable goods, but retail trade, income, and other important measures also showed good gains. Less favorable were the final report of the National Industrial Conference Board's survey of capital appropriations, the Dun and Bradstreet survey of businessmen's expectations, and the failure of the ragged series on housing starts to reverse the drop it took in June.

It is difficult to summarize labor market developments in a few words. Movements appear to have been sideways, on balance, with the data continuing to carry ominous indications of trouble ahead, if and when there is a resumption of expansion in the labor force.

The very sketchy information we have from weekly data for early August suggest that the improved July levels of production and sales were holding in the first part of the current month.

The most encouraging aspect of recent developments, in my judgment, is that they have been almost completely free of those overtones which we associate historically with the final stages of a boom. There is no general expectation of inflation, no bulge in credit buying, no scramble for inventory. The improvement, while very moderate, seems to be basic and healthy. It does not appear to be associated with any "one shot" increase in Government expenditures or revision of taxes--in fact, the trend would seem to be toward somewhat more stimulus from the Government sector in the current quarter and those ahead than in the one just past, when to everyone's surprise Government cash receipts and expenditures, after adjustment for seasonal variation, moved to a precise balance--a sharp cutback from the \$3.2 billion deficit in the first quarter. Nor does the improvement seem traceable to the changes in depreciation allowances, or the prospective investment tax credit. Whatever stimulus may come from these changes still lies ahead.

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I have said rather wistfully on several recent occasions that it seemed to me the best thing that could possibly happen--and perhaps the only thing that would prevent an almost untenable situation--would be some autonomous improvement in basic economic conditions, not directly associated with either fiscal or monetary policy.

It would be foolhardy to suggest that the July and early August data point clearly to any such change, but the wish seems a little less unreasonable today than it did a month ago.

To avoid any possible misunderstanding, let me be explicit on two points: first, the moderate improvement in July still does not carry activity to rates which could be said even to approach an adequate level of resource utilization; second, far from calling for any lessening in the ease of credit availability, it suggests to me that perhaps we may finally get some of the long-awaited domestic business loan demand that would add to the forces of recovery and expansion, and that everything possible should be done to encourage such a development.

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

If one could judge the attainments of monetary policy by interest rate indications alone, the past three weeks would seem to be a period in which several different objectives attributed to policy have been furthered. The money market was firmer; covered interest rate incentives to the movement of liquid funds abroad were substantially reduced; while yields turned downward and availability of funds eased in a number of credit and capital markets in which key domestic demands for funds are accommodated.

The Manager of the Account has already outlined the groundswell of improved investor sentiment that swept through the markets for debt securities, moving these markets into strong technical positions. Heightened investor interest was apparent in every instrument from Treasury bills to long corporate bonds. Market yields moved down correspondingly, except in the short-term sector where official action added to available supplies.

These developments by and large emerged from happenings outside the banking system. During this period, free reserves ranged narrowly around \$350 million, save for the week of August 15 in which a late float bulge and the churning of cash flows incident to Treasury interest payments and the financing settlement led to a temporary and little-utilized rise in average free reserves to \$436 million. Borrowings from the Federal Reserve were up somewhat, but excess reserves--chiefly at country banks--also seemed to be running somewhat lower than earlier. Federal funds rates moved up to 3 per cent during most of this period, but

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a large volume of funds appeared to move into the money centers at such a rate and no bind in the availability of Federal funds developed. In contrast to earlier experience, this funds rate movement did not bring a companion firming of bill yields; city banks did unload substantial quantities of bills, but nonbank investor demand steadfastly held the bill rate below the funds rate.

Total bank utilization of reserves declined during late July and the first half of August, on a seasonally adjusted basis. Required reserves behind private deposits dropped almost \$150 million below the standard projected in the staff memorandum, despite a contemporaneous decline of Government deposits which might have been expected to bolster private deposit totals. This flagging bank reserve utilization had its counterpart in an estimated further \$200 million decline in the average money supply during the first half of August, and in a marked slowdown in time deposit growth after mid-July. The slowing of time deposit expansion appears entirely accounted for by declines in nonsavings accounts; passbook savings have actually been somewhat stronger at reporting banks recently than in previous months. An upsurge in bank credit and deposit totals may be expected after August 15, reflecting bank purchases of an estimated one-half billion dollars more of the new Treasury issues than they held of the maturing obligations. At the same time, private deposits are expected to drop sharply, at least for a time, reflecting shifts to Treasury accounts of the proceeds of \$1 billion or so net nonbank purchases of the new issues.

During recent weeks banks have been expanding further their holdings of municipal and Federal agency issues-- particularly the latter--and have been reporting sizable but erratic fluctuations in securities loans and loans to other banks and finance companies. The total of private demand for bank credit by nonfinancial users, however, continued to be relatively moderate. If anything, recent city bank figures might be read as suggesting some slackening of the rate of increase in real estate and consumer loans. I should call the attention of the Committee, however, to an underlying tendency for business loans to increase which appears to be more than transitory in its direction and more than seasonal in its nature. In the past month, business loans at city banks have advanced about one-quarter billion dollars. This is a greater increase than in the comparable periods of prior years, and it appears to be centered not only in the types of borrowers from whom one would expect some beginning growth in seasonal needs but also in lines with more cyclically sensitive needs for bank funds, such as metals manufacturers and public utilities. Before such an uptick in business

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loan demands is extrapolated into the fall, consideration needs to be given to the influences mitigating against loan increases of major cyclical significance. These include the large current cash flow of businesses and the relative absence of incentives for inventory accumulation. For firms with access to alternative sources of financing, a more pervasive influence dampening the rise of bank credit may be the comparative cost of funds. The rate margin of short-term open market paper below the bank prime rate is conspicuously wider than in preceding periods of cyclical expansion, and the same appears to be true with respect to new offering yields on corporate bonds compared with average bank term loan rates. Such changes in interest rate relationships inhibit our ability to reason from past experience. By diverting some credit demands from banks to other sources, they depress the banking totals to a much greater degree than they do the underlying economic activity in question; they make it easy to infer over-bearish conclusions from banking developments.

This same difficulty also plagues observers of the liability side of bank balance sheets, as the emergence of relatively rewarding rates of return on time deposits and other near-monies has increased interest incentives to minimize balances in checking accounts. What is the significance of a money supply thus depressed? Certainly depositors who exchange demand balances for near-monies do not give up spending potential, but in enjoying a heightened rate of return for nonspending they may lose some spending incentive, that is, they may be led to postpone or otherwise reconsider some marginal acquisitions of goods and services. Can such a marginal loss of stimulus be offset by, say more than proportionate additions to liquid asset holdings? Common sense would say yes, at least within limits, but the question of how much is enough seems essentially unanswerable. At this stage of our knowledge, we can only hope to discern from the facts if any extreme situation is developing.

The facts show that consumers and businesses are spending slightly less on goods and services, are borrowing less, and are engaged in somewhat more net financial investment, in relation to their incomes, than in the corresponding expansion phase of the previous two cycles. Their net financial investment has flowed into near-money liquid assets and into other securities. In the process holdings of liquid assets have increased more than in the recovery stage of other recent cycles, but are now back to a level that appears no higher in relation to capacity output than was characteristic of the 1959 expansion, and this ratio remains well below the levels reached earlier in the 1950's. Those publicly-held financial assets which showed a disproportionately greater growth relative to potential capacity output were total

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securities other than short-term Governments, and the stock market shakeout has reduced the aggregate market value of these holdings to their lowest ratio in five years.

What these figures suggest is that the private economy has acquired a capacity to spend out of financial assets which, when related to its ability to absorb such spending, is not particularly out of line with recent experience. If anything, current holdings seem on the low side. The inclination to spend, meanwhile, is less. These seem to me to be circumstances in which it is reasonable to expect to find still operative some of the traditional marginal responsiveness of private decision-makers to changes in general credit and liquidity conditions.

Mr. Furth presented the following statement with respect to the U. S. balance of payments and related matters:

At the end of the second quarter of this year, our balance of payments figures were not bad, largely because of temporary inflows from Canada, but the prestige of the dollar in international gold and exchange markets was very low.

Lately, the situation has been reversed. The deficit in our international payments has again increased, in part because of the reflux of funds to Canada, but the market position of the dollar has improved.

In July, we received advance payments from France and Italy totalling \$470 million. Disregarding these extraordinary receipts, however, transfers of gold and convertible currencies to foreigners amounted to \$450 million. In the first two weeks of August, transfers apparently continued on the same scale. Perhaps half of these transfers were due to the expected reflux of funds to Canada; moreover, seasonal factors may account for part of the continued flow of dollars to Italy and also to France. But even so the adjusted deficit, while much smaller than in the third quarter of last year, has been larger than expected earlier this year.

In July, the transfers to foreigners were mainly in gold. Since the end of July, all the transfers have been in dollars or, to a lesser extent, in foreign convertible currencies. Sooner or later, however, France is going to convert part of its dollar accruals into gold.

Abroad, the boom in Europe and Japan continues to subside, but without showing signs of an imminent downturn. There is thus no reason to expect a decline in our exports to foreign industrial countries, except to Canada. On the other hand, financial and political disturbances in less developed areas, including especially South America, continue unchecked, and there is no

reason to expect an increase in our commercial exports to those important markets.

In view of the continued sluggishness of our economic expansion together with the decision of the Administration to forego, at least for the time being, the use of expansionary fiscal policies, our imports are not likely to rise rapidly. Our export surplus may therefore be expected to remain at about the level of the first half of the year.

On the other hand, our economic situation will not make the United States any more attractive to international investment capital, and we must expect the net outflow of long-term capital to continue.

Private demand for gold in the London market seems to have declined, although it remains high enough to keep most of the newly mined gold out of monetary reserves. But the net drain on the Bank of England, which ultimately means a drain on our gold stock, has been greatly reduced if not completely eliminated.

On the major exchange markets, sterling is weak and the Canadian dollar very strong. The U. S. dollar stays at the floor against the French franc and the Italian lira, reflecting the continued reserve accumulations of these countries. But the dollar has remained off the floor against the other major European currencies, and this fact should contribute to a more rational market attitude toward the prospects of our dollar and of our economy in general.

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

The most important development related to the economy that has occurred since the last meeting of the Committee is the President's decision not to seek a cut in taxes at this time. As the President stated in reporting his decision, "the pace thus far this summer, while not as good as all of us would have liked, has brought still further gains." The economic statistics for July are on the whole somewhat better than those for June. Yet some of the improvement was due to the absence of certain adverse factors that were present in June.

On the basis of available data there are at least three possible views on the economic outlook:

- (i) A pessimistic view, envisaging a downturn before the end of the year. Proponents of this view would stress recent weaknesses in foreshadowing statistics.
- (ii) A middle-of-the-road view, envisaging the economy moving sideways or mildly upward. While proponents of this view see no signs of real upward momentum, neither do they see much evidence of developing downward pressures. They would point out, for

example, that inventories remain low in relation to sales, and they would give minimum weight to some of the foreshadowing statistics on the ground that to some extent their recent behavior has reflected temporary factors.

- (iii) An optimistic view, seeing gain in underlying strength since a variety of uncertainties and shocks have been weathered smoothly.

I lean toward the middle-of-the-road view. In any event, it is clear that the economy will remain well below its output potential for some time to come.

July data on bank credit show little change in basic trend compared with May and June. While there was a reduction in total bank credit in contrast to increases in the preceding months, this was due mainly to the absence of major Treasury financing. Except for the continued strength in real estate loans, loan demand was not impressive; there are, however, indications of a somewhat more than seasonal pick-up in early August, especially in business loans. While the adjusted daily average money supply declined in July for the third month in a row, time deposits continued to rise. The money supply plus time deposits continued to expand.

As the President said last week, in reporting an improvement in our balance of payments in 1961 and 1962, "we still have some distance to go." For the first half of 1962 the seasonally adjusted annual rate of deficit was about \$1.4 billion. Preliminary estimates for July indicate that we were just about in balance when we include the \$471 million debt prepaying by France and Italy; the more significant and ominous fact is that without the debt prepayment we would have had a \$450 million deficit (unadjusted) for the month. Canada's financial difficulties were an important factor in our good showing in the second quarter. In the third quarter we have felt, and will continue to feel, the effect of a return flow of funds into Canada, following the recent financial measures taken by Canada. Preliminary balance of payment data for August are discouraging. Indeed, we still have some distance to go in solving our balance of payments problem; meanwhile we face the constant risk of a weakening of foreign confidence in the dollar. While the problem may not now be critical, it certainly is pressing.

The President's decision not to seek a tax cut at this time, and not to seek spending authority beyond that already requested, is an important factor to be taken into account in determining what is appropriate monetary policy. There has been much talk in recent weeks about the possibility of a

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change in the "policy mix." It now appears that, for the time being at least, there is to be no basic change in that mix. There is to be no fundamental change in the burden to be borne by fiscal policy.

As for monetary policy, if one looks just at the domestic economy he might conclude that more monetary ease is called for. I doubt, however, that more ease would really provide any substantial stimulation to the economy. An easy credit condition has been continued longer in this recovery than in any other in recent decades. Large amounts of bank reserves have been made available, more than offsetting the losses resulting from the gold outflow. We still have basically easy credit conditions. The banks are comfortably liquid and anxious to lend. The public's holdings of liquid assets are ample.

Our balance of payments problem also counsels no greater ease in monetary policy. While somewhat higher interest rates here would help our balance of payments, in view of the domestic uncertainties it does not seem advisable to make any change in monetary policy at this time.

A major decision on fiscal policy having just been made by the Administration, it would seem desirable for the Federal Reserve to maintain the status quo while the air clears--while the implications of the fiscal decision become more clear. The maintenance of the status quo is also suggested by the prospective Treasury advance refunding.

As for money market guides in maintaining the status quo I would suggest that the Federal funds rate be in the 2 3/4-3 per cent range, with the rate at 3 per cent much of the time, and that the three-month Treasury bill rate be in the 2 3/4-3 per cent range, with the rate preferably in the upper part of the range much of the time. I see no reason for any change in the directive, other than perhaps to delete the references to the unsettlement of financial markets and the behavior of such markets. I see no reason to consider a change in the discount rate at this time.

Mr. Bryan said a considerable quantity of new statistics for the Sixth District had become available. Unfortunately, figures for a Reserve District tend to lag behind those for the nation; the statistics to which he referred related mostly to June rather than July. These showed that nonfarm employment and manufacturing employment were up, and that there had been an increase in demand deposits and currency. A number

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of other statistics also looked moderately favorable. Construction contract awards were down sharply, but that figure was for May.

Mr. Bryan noted that the money supply, conventionally defined, had been down for three consecutive months. Also, it seemed to him that the rate of growth of time and savings deposits was definitely showing a tendency to slow down. He further noted that there had recently been a rather sharp drop in required reserves, which had the effect of making the free reserve figures look higher than they would otherwise. The Committee, he suggested, might have to be particularly alert in the next few months to avoid an inadvertent tightening that it did not desire.

Mr. Bopp reported that developments in the Third District had been mixed. Department store sales continued to show year-to-year gains, but the rate of gain was decreasing. Manufacturing employment declined in July, but the decrease was seasonal and small. Steel production had been increasing. Amid all the pluses and minuses, both nationally and regionally, one fact seemed to show through: unemployment was still undesirably high. In the Third District, there were still six major areas of substantial labor surplus. Nationally, the slight decline in the rate of unemployment reflected primarily the small change in the labor force rather than an increase in employment.

Banking in the District also showed a mixed picture, Mr. Bopp said, but on balance there was some evidence of a gradually less easy situation.

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As for policy, Mr. Bopp expressed the view that the data for July were not sufficiently conclusive to warrant a departure from a program of stimulating the domestic economy through monetary ease. He continued to view the underutilization of economic resources as the primary problem facing the Committee. Although the balance of payments was also a serious problem and was far from solved, it had nevertheless been improving and the risks of monetary ease seemed somewhat less. Perhaps more important, however, it now appeared that less could be expected from a stimulative fiscal policy than seemed possible earlier; and this, too, would argue for further stimulation through monetary policy.

Mr. Bopp said that he would not recommend any change in the discount rate at this time. However, a change in the current policy directive which would indicate a greater willingness to encourage expansion seemed to him in order. With two modifications, the directive issued at the Committee meeting of May 29, 1962, would accomplish this purpose. That directive read:

In view of the modest nature of recent advances in the pace of economic activity, the continued underutilization of resources, and the uncertainties created by the disturbed conditions in some financial markets, it remains the current policy of the Federal Open Market Committee to promote further expansion of bank credit and the money supply, while giving recognition to the country's adverse balance of payments.

To implement this policy, operations for the System Open Market Account during the next three weeks shall be conducted with a view to maintaining a supply of reserves adequate for further credit and monetary expansion, taking account of the desirability of avoiding sustained downward pressures on short-term interest rates.

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A minor change would be necessary: In the first sentence the word "remains" would have to be changed to "is." The reference to disturbed conditions in some financial markets could also be removed.

Mr. Bopp said he would interpret such a directive as meaning somewhat lower market rates, with Federal funds trading more consistently around 2-1/2 to 2-3/4 per cent, reserve availability fairly liberal, and, in view of the slowing upward trend of time and savings deposits, more consideration given to expansion of total reserves and the money supply.

Mr. Fulton reported that business activity in the Fourth District had expanded somewhat during July, with evidence of slight gains carried forward into August. Auto sales rebounded vigorously in July, and this vigor apparently was carrying over into August. Department store sales peaked in the latter part of July, and since then had remained at the July level. The lack of material improvement in unemployment stemmed principally from the slowdown in the auto industry that occurs prior to the model changeover; there had been some favorable changes in unemployment in other industries. While the trend of electric power production had faltered, the level was not down too much from the latter half of July. The volume of building permits issued in Cleveland and Cincinnati suggested that building activity was being maintained.

As to the steel industry, Mr. Fulton said there had been only moderate improvement from the low June and July figures. August shipments were said to be about the same as in June. Inventories at the mills and in

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the hands of customers were being maintained at what was called a "lean position." It was understood that a major auto producer had indicated to a mill that its requirements for the fourth quarter would be 30 per cent below normal, as the company was continuing to liquidate inventories. Nobody seemed to know, with auto production as high as it had been, how the auto companies had obtained inventories to last for such a long time. There was a suspicion that after the turn of the year the companies would begin to inventory some steel against the possibility of a reopening of the steel wage contract, which could be reopened prior to the end of June.

If steel operations should return to a more favorable level, Mr. Fulton said, the Fourth District would show a substantial degree of activity, since other industries were not doing too badly. The principal question was whether the auto industry, which takes a large tonnage of steel, would have two good years in a row. One industry source had expressed the view that 1963 should be a 6.2 to 6.4 million car year, which would be a good year. In brief, steel prospects seemed to revolve largely around the auto industry. And with steel so predominant in the Fourth District picture, this relationship meant that the economic health of the District was likely to depend in considerable measure on the auto industry.

Mr. Fulton expressed the view that the execution of monetary policy had been good and that the Committee had achieved about what it sought. He felt that free reserves in the range of \$350-\$400 million would be appropriate. The discount rate should be maintained without change, and

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the directive seemed appropriate except for the clause relating to unsettlement in financial markets, which he would favor deleting.

Mr. Mitchell presented the following statement:

I continue to believe that monetary policy can make a contribution to economic expansion without significantly adverse effects on the balance of payments. Since the last meeting of the Committee there have been more encouraging than disappointing economic statistics. But in these day-to-day and hour-to-hour bulletins there are many reversals and, as in the recent past, good news has been followed by setbacks. What is more significant today is that the President has indicated that unless there is a notable change for the worse in economic developments there will be no tax cut before 1963, when Congress will give consideration to a broad-based tax reform measure. In the interim it is more important than ever that monetary policy encourage economic expansion.

For those who are concerned with changes in the money supply, and over the months and years I believe all of us have to regard this guideline as significant, it is a matter of increasing concern that we have had no monetary expansion since November of 1961. This stark fact has been alibied in a variety of ways: (1) bank assets have shown a near-record gain and time deposits have risen spectacularly, (2) monetary expansion in the three months previous to December 1961 was sufficient for some time, (3) turnover increases indicate that velocity changes are making up for any short-fall in money supply, (4) the money supply cannot be made to rise without the risk of inflation. What is the point about each of these arguments?

The gain in bank assets largely reflects the growth in time deposits following the raising of the Regulation Q ceiling. Without this special circumstance, bank assets would have increased by less than 2 per cent in January-July 1962. More than half the growth in commercial bank credit since December is attributable to the extraordinary increase in time deposits. Much of this extra growth in time deposits represents a shift in the flow of savings toward commercial banks as intermediaries. The corresponding increase in bank assets cannot be regarded as stimulative to the economy.

The trouble lies in the fact that some of the guides urged on us confuse the act of monetary creation, for which this Committee primarily exists, with a more or less ministerial act of accommodating the growth of banks as savings institutions or financial intermediaries. It has become a routine operational

procedure to provide and withdraw reserves to accommodate currency and gold flows and to superimpose monetary decisions on the altered base. It should normally also be a routine operational procedure to provide the reserve base for Government deposits and for time accounts in commercial banks. Neither of these bank liabilities is directly related to monetary creation. By deleting the changes in reserves associated with Government and time deposits as well as currency and gold stock, a much clearer conception of the Committee's work and objective can be attained. Looked at in this light, the activities of the Committee in the past nine months have resulted in no money creation--absolutely none. The entire increase in reserves since last autumn--about \$300 million--was needed merely to support the growth in time deposits.

Did we create enough additional money in the fall and late summer of 1961 to last for 1962? On the contrary, that short-lived monetary expansion was itself long overdue. In 1960 there had been an actual contraction in the money supply. From the trough of the recession in February 1961 through the end of the year, the money supply rose less than 3 per cent while GNP in constant prices grew by 7 per cent. In other words the money supply did not grow during the period of recession and its growth was inadequate during the period of recovery. The disappointingly-slow expansion in GNP since the end of 1961 has coincided with the failure once again of the money supply to increase.

Can we depend on velocity changes to make up for our deficiencies in adding to the money supply? It is true that over the past 11 years (1952-1962) turnover has been rising secularly at the average rate of about 5 per cent per year. This rise has been associated with technological changes in the use of the means of payment, the ensuing stepped-up frequency of payment and a great variety of changes in spending-financing patterns, many of which were encouraged by the secular rise in interest rates over the past decade. Moreover, all during the fifties, in addition to secular changes in turnover, we can observe cyclical reactions superimposed on the secular developments. Monetary velocity has tended to rise more rapidly in periods of high interest rates and has slackened in periods of relatively low interest rates. But just as the secular rise in interest rates has dominated the cyclical variation, so the secular rise in velocity has overwhelmed its cyclical movement. These facts suggest that deficiencies in our actions may tend to be offset by an automatic response in the turnover ratio. But too much dependence should not be placed on this reaction. To a significant extent the rise in turnover may represent a reaction forced on the economy by inadequate growth of the money

supply. Just as a community with a water shortage will adapt itself to this inconvenience in various ways, the American economy has adapted itself in recent years to the slow growth in money supply by economizing its use, thereby pushing up deposit turnover. A faster growing money supply, however, would have interfered less with economic expansion.

Are there inflationary risks in monetary expansion? At a time when the economy is operating well below capacity and cost-push influences are notably absent, inflationary dangers are remote. Furthermore, despite the very large increase in time deposits this year, liquidity positions are far from ample.

Having considered and rejected four rationalizations for the failure of the money supply to grow, I conclude by considering how we may go about achieving needed monetary expansion. The fact is that at the present time the banking system would expand the money supply by acquiring assets if we were to supply the necessary reserves. The road block is the present free reserve target and the way around it is to engage in more aggressive open market purchases.

At this time, such a policy would put less downward pressure on short-time interest rates than at other times of the year. The economy is entering a period of seasonal loan expansion and seasonal rise in bill yields. At a minimum the Committee should anticipate these seasonal forces by supplying reserves more aggressively and earlier without fear of undue reductions in short-term market yields.

Beyond this I believe some reduction in bill yields could be tolerated. I would let bill yields decline to 2-1/2 per cent, if necessary, to achieve money supply growth. Furthermore, I would minimize the impact on bill yields by purchasing as much as feasible in the intermediate and longer term maturities.

Mr. Mitchell concluded by stating that he would endorse the changes in the policy directive that had been suggested by Mr. Bopp.

Mr. King suggested that there should not be overlooked, in discussing the lack of growth of the money supply, as conventionally defined, the effect of the action taken as of the beginning of this year increasing the maximum permissible rates of interest payable on time and savings deposits. As he anticipated when the action was taken, that had been a

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factor on the side of restricting the growth of the money supply, and it should be given consideration.

Turning to the policy directive, Mr. King expressed the view that it should be changed. He presented for consideration the possibility of deleting the last two sentences in the first paragraph of the outstanding directive, which he felt served mainly to elaborate the statement in the first sentence. The deletion of those two sentences would make the directive rather brief, he noted, and someone might wish to suggest other language in substitution.

Mr. King noted that the Government securities market had been showing some strength recently. In his view, this reflected a fundamental force in the economy at the present time, and no effort should be made to put a floor under the rate structure if there was a tendency for rates to decline somewhat. Instead, the Desk should operate in such manner as to allow the bill rate to do more or less what it wanted to do at this particular time. He did not believe that natural forces would operate to such an extent as to endanger objectives with which the Committee had been concerned, at least not to the same extent as might have been the case some time ago. In conclusion, Mr. King said that he would not favor a change in the discount rate at this time.

Mr. Shepardson commented that the economic situation looked a little more encouraging at present than at the time of the previous Committee meeting. The season of the year was approaching, he noted, when one would normally expect an upturn in economic activity, and the System should be

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prepared to provide the needed reserves for such expansion as might occur. At the same time, he felt that the general level of credit policy had been entirely appropriate, and he would suggest no change.

Mr. Mills said there appeared to have been no pronounced economic developments since the preceding Committee meeting on which to base any change in System policy. No one seemed able to determine whether this reflected the usual summer slackness or whether it reflected a relatively general economic sluggishness, and this was a further argument for going along with existing policy. He agreed with those who would favor eliminating from the policy directive the phrase having to do with unsettlement in financial markets.

Mr. Mills went on to say that he felt sure everyone had listened with much interest to Mr. Mitchell's exposition of policy reasoning. He believed Mr. Mitchell's point of view required an answer, even though an extemporaneous reply would obviously be less fully developed than Mr. Mitchell's presentation.

After these prefatory remarks, Mr. Mills commented that the lack of credit creation cited by Mr. Mitchell was a matter of concern, and an element in the lack of general economic growth that the nation had been experiencing over the past several months. However, when a reduction in required reserves was noted, a case could be made that that development was a reflection of an absence of demand for bank credit, rather than any conceivable inadequacy of free reserves on which to base an expansion of credit. Granted that the level of required reserves may have been influenced by factors such as the marked shift in U. S. Government deposits

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and Treasury financing operations, nevertheless there was no question but that required reserves had dropped, and he thought there were good grounds for tracing this decline to the absence of existing demands for credit. Reserves had been available in adequate amounts, in his opinion; a superimposed reflection of that fact was the tendency for the long-term interest rate to fall. That tendency had been abetted by an ample flow of investment funds into the market and by a lack of exceptional demand for the use of such funds. As he saw it, these were economic elements on the side of adding force to business growth whenever a demand for credit did develop. In the present posture of the economy, he believed that the adequate availability of credit, both long- and short-term, was not open to serious question.

Mr. Wayne reported that although Fifth District business apparently advanced in July, the evidence was both mixed and incomplete. Bank debits rebounded to a new high after declining in June. Department store sales in July rose 2 per cent to a level exceeded only in March and May of this year. The Reserve Bank's triweekly survey of District business leaders, which was thought to have pretty well established its usefulness as a barometer of business opinion and guide to current developments, particularly in manufacturing, showed improvement in general sentiment for a second three weeks following a period of declining confidence that extended from February to June. Surveyed businessmen also reported small recent gains in employment and trade, and further declines in unemployment. Manufacturers in the survey indicated virtually no change in employment or shipments, but a rising trend in inventories and wage rates and

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significant declines in new orders, weekly hours, and prices. These trends, which appeared earlier in durable goods, had now spread to non-durables and were especially apparent in textiles. Real estate loans had continued to expand at District banks, and business loans, seasonally low in July, rose sharply in the first week of August.

Mr. Wayne said that, as he saw it, the economy was continuing its gently undulating movement with a slight, barely perceptible upward tilt. Currently, it seemed to be making a mild recovery from its third dip during the present upswing, but there were no indications of sustained improvement. As had been true for many months, ample bank credit was available at moderate rates of interest. Recently a small group of prominent business leaders in the Fifth District was asked about the availability of credit and its relation to the current sluggishness of the economy. Without exception they replied that the business hesitation was in no way caused by any shortage of credit or by prevailing levels of interest rates. One member of the group stated that for the first time in years he had been solicited by representatives of New York banks for loans, but that he had not borrowed because he could not profitably use the funds. These and other more general pieces of evidence indicated that no easing of credit was likely to increase the tempo of business. Since there had been, on balance, no significant improvement in the international situation, there was no room for maneuver there.

For these reasons, Mr. Wayne said, he would favor continuation of approximately the same degree of monetary ease that had prevailed for the past four or five weeks. By this he meant a bill rate at 2.85 per cent,

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give or take four or five points. For free reserves, he would suggest a target range of \$350-\$400 million. The Manager of the Account, however, should have discretion to depart from those targets temporarily as market conditions dictated.

Mr. Wayne said he would renew the present policy directive-- although he would not be troubled by elimination of the clause referring to unsettlement in financial markets. He would not favor any change in the discount rate.

Mr. Clay commented that the improvement in the level of domestic economic activity in recent weeks was an encouraging development. While recognizing this fact, a more accurate perspective on the state of the economy could be obtained by taking a longer-run view of the situation in order to consider the underlying forces at work. In other words, the perspective could be improved by not focusing attention too narrowly on either the more favorable data for the last month or the less favorable data for the preceding month.

In approaching the analysis of economic developments in this way, it became apparent that the basic situation had not changed recently and in fact had remained essentially unchanged throughout this year. There was still the problem of obtaining adequate expansion in economic activity relative to capacity in terms of available manpower and other resources.

The manpower aspect of the problem must be judged not only in terms of the current level of unemployment and the prospects for added employment in the months ahead. Account also must be taken of the lack of significant growth in the civilian labor force during the current upswing,

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despite the growth in working age population, and the strong probability that a marked labor force growth would take place in the months ahead. Furthermore, industrial capacity continued relatively ample, and there was as yet no evidence to indicate an acceleration in business capital outlays, upon which any strong expansion in economic activity appeared to depend. Taking all factors into account, the prospective pace of economic advance remained in keeping with the moderate proportions of the year to date.

It was Mr. Clay's view that on balance the domestic economic situation continued to call for an expansive credit policy. Member bank reserves should be applied in sufficient volume to permit bank credit expansion on a seasonally adjusted basis. The moderate decline in open market yields in recent weeks had been a favorable development. Taking into account the international balance of payments problem, he felt that the Committee's objective on the Treasury bill yield might appropriately be in the 2.80-2.85 per cent range for the period immediately ahead, but it did not appear to be necessary to press for a higher yield at this time. On the other hand, some further downward movement in longer yields would be desirable. Market forces might tend to produce lower long-term yields in the period ahead, and in that event the Committee should not take any action to prevent such a development. Mr. Clay recommended no change in the Reserve Bank discount rate.

Mr. Scanlon reported that during the past several weeks developments in the Seventh District had presented a mixed picture. Retail sales rebounded in July and this trend apparently was continuing in August.

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Changes in the employment situation were of a seasonal nature. Many Midwest business economists were predicting continuation of about the current levels of activity for the next several months, with a general business decline thereafter. Auto sales during July and early August were at a high level, and inventories of 1962-model cars were being reduced rapidly. The demand for producers' equipment was mixed. The demand for electrical generating equipment was a bright spot, but in general capital goods industries continued to report sluggish business, with little likelihood of a substantial pickup. While there had been a moderate gain in steel orders, the rate of output was low, and inventories were being reduced. Home building continued slow in the District.

Warm weather in July had improved crop conditions in the North Central States, Mr. Scanlon said, particularly in the central corn belt. Corn production was expected to be 2 per cent higher than in 1961, despite a 1 per cent decrease in acreage, and it appeared that the soybean crop would reach a record high.

Loans at District weekly reporting banks were down in July and early August, as compared with the preceding year, and bank holdings of Government securities were also reduced.

Turning to policy, Mr. Scanlon said that to him open market operations during the past three weeks seemed to have followed a course midway between "providing moderate reserve expansion" and "fostering a moderately firm tone in money markets." The result had been a further decline in bank credit and the seasonally adjusted money supply, while short-term market rates gave mixed signals. In his opinion, during the next three weeks greater emphasis should be placed on providing for moderate reserve expansion.

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As to the policy directive, Mr. Scanlon expressed agreement with the deletions suggested by Mr. Treiber. He added that he would not favor a change in the discount rate at this time.

Mr. Deming said the Ninth District apparently felt rather good about the current economic situation, and it had reason for that feeling. Crop prospects improved substantially further during the critical July and early August period, and near-record small grain production was now assured. The only exception to this statement was seen in South Dakota, where rust had cut back production estimates substantially. Among other crops, surplus moisture and cool weather had retarded corn and soybeans in the eastern sections of the District. Even so, total tonnage of District grains would be large and, with favorable livestock marketings at good prices, would boost cash farm income in the last half of 1962 by 5 to 10 per cent over the comparable period of 1961.

Retail sales had been improving, Mr. Deming noted, and should show further gains now that a long newspaper strike had been settled. Non-agricultural employment in July rose modestly; bank debits were up 5 per cent (seasonally adjusted) in the month. July personal income was more than 7 per cent higher than a year ago, a substantially better year-to-year gain than recorded for the United States as a whole.

The Reserve Bank's current survey of recent developments and expectations indicated that these favorable developments continued through mid-August. Respondents also indicated confidence in immediate future developments, although on August 15 slightly more saw stability continuing

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at present levels and slightly fewer saw improvement as fairly certain than six weeks ago. The proportion believing that some improvement was probable remained about the same. Only one or two respondents saw a decline as probable or certain in the next several weeks.

Recent District banking developments had been mixed and difficult to interpret. At country banks, total deposit growth in July was about normal but, as had been the case in all months this year, time deposit increases were much larger than in the comparable month last year. Country bank loans showed virtually no change in July, a not unusual occurrence. (Last year they fell rather sharply.) The loan-deposit ratio of these banks was about the same as in July 1960, a bit lower than in July 1961, and down a bit more from its peak. At city banks, total deposits dropped in July for the first time since January. In most Julys, total deposits at these banks had increased. This July the decline reflected entirely a drop in U. S. Government deposits; other deposits were up but time deposit growth had diminished. City bank loans also declined slightly in July, again the first decline since January. So far in August, however, city bank loans were up and, if the August trend continued, would be up substantially more than usual for that month. The loan-deposit ratio at these banks was about 4 points above its low of last winter, but still 7 points below its peak of June 1960.

More striking, and perhaps more significant, than these recent happenings were developments in total bank credit during the first seven months of this year. So far in 1962 total loans at all member banks had

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registered the largest increase for that period of all the postwar years save one, 1959. In that year, however, most of the loan increase was financed by liquidation of investments; this year there has been little net investment shrinkage. As a result, bank credit expansion in the District had been at a record level, exceeding slightly the previous high of the first seven months of 1958. There had been little borrowing from the Reserve Bank, and about as many sales as purchases of Federal funds. There certainly had been no pressure on Ninth District banks.

As to policy, Mr. Deming said that for the coming three weeks he would like to have policy continue about as at present. In his view, the Desk had achieved rather well the objectives of the Open Market Committee during the past three weeks. It had succeeded in maintaining an adequate availability of credit without putting appreciable downward pressure on the short-term rate, and he would like to see those conditions continue.

As to the directive, Mr. Deming said he would have no particular objection to deleting the phrase that referred to unsettlement in financial markets. Aside from that, he would suggest no change in the directive, and he saw no reason to change the discount rate.

Mr. Swan reported that available July data for the Twelfth District contained no great surprises. In the Pacific Coast States employment again was up, while the seasonally adjusted rate of unemployment dropped from 6.1 per cent to 5.9 per cent in July after having risen from May to June. The July increase reflected a resumption of previous levels of construction activity following the settlement of a major labor dispute, a

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delayed pickup in agricultural activity, and a continuance of the increase in defense-related employment. On the other hand, lumber demand weakened considerably in June with dampening effects on production and prices, which reflected more than the usual seasonal decline. Department store sales appeared to have shown little gain from June to July. However, the daily average rate of new car registrations in California was higher in June than in any other month of 1962, and the June rate was exceeded appreciably by the daily average rate in the first half of July. In general, the situation in the District continued somewhat mixed, but with perhaps some moderate improvement.

Mr. Swan went on to say that District weekly reporting member banks showed losses in demand and time deposits for the three weeks ended August 8. Savings deposits continued to rise but the increase was more than offset by a fairly substantial decline in other time deposits. This resulted in increased pressure on reserve positions. District banks were net purchasers of Federal funds in this period, and they were substantial borrowers from the Federal Reserve Bank in the week ended August 8. Thereafter the situation shifted a little; in the week ended August 15 the banks were net sellers of Federal funds, while borrowing from the Reserve Bank dropped off quite sharply. District banks were expected to be net sellers of Federal funds again in the statement week ending tomorrow.

Turning to the national picture, Mr. Swan said it seemed to him that July business developments had clarified the outlook only to the extent that an imminent downturn in activity was less likely. On the other

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hand, the data also continued to suggest the unlikelihood of any early resumption of a stronger rate of expansion. The abandonment of plans for an immediate tax reduction, current plans for plant and equipment expenditures by businesses, current inventory policies, and the results of the most recent survey of consumer buying intentions combined to suggest nothing more than a continuation of present levels of activity, or at best a slight further rise, in the immediate future.

Consequently, Mr. Swan believed, in terms of policy, that certainly there should be no trend toward lesser ease. Instead, he would like to see a modest but nevertheless definite move in the other direction. He subscribed to the desirability of placing greater emphasis on moderate reserve expansion than on the maintenance of a moderately firm tone in money markets. What he had in mind could be accomplished, he thought, without an undue decline in short-term rates. He would not change the discount rate at this time.

As a minimum change in the current policy directive, Mr. Swan favored removal of the reference to unsettlement in financial markets. He had some sympathy with Mr. Bopp's suggestion for going back to the May 29 policy directive. On balance, however, he felt that perhaps it would be better to change the existing directive slightly.

Mr. Irons reported that during the past several weeks there had been a slight but fairly general strengthening of activity in the Eleventh District. July figures and August indications reflected a slight upward movement. For the year to date, department store sales were up 6 per cent

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from the previous year. In petroleum, refining was up slightly while production and drilling were holding about steady. An eight-day allowable basis continued in effect. The industrial production index for Texas was up another point to a record high, and nonagricultural employment had risen slightly--also to a new record. Construction activity was up quite substantially, reflecting the booming construction conditions in two of the major cities--Houston and Dallas--as well as some other areas. In agriculture the situation was about normal for this time of year, with conditions ranging from drought to heavy rainfall in different parts of the State. Indications were for a larger than normal cash farm income this year, with an increase in agricultural output. The rate of unemployment in Texas was running about 5 per cent.

On the financial side, Mr. Irons saw no evidence of inability to satisfy credit demands and no evidence of illiquidity on the part of District banks. Total loans had declined a bit but business loans were up, along with investments. Deposits--both time and demand--also were up. Excluding two banks that were consistent buyers, purchases and sales of Federal funds were not far from being in balance and borrowing from the Reserve Bank was nominal, running at about \$6 to \$8 million daily average. There had been no complaints from banks about inability to meet credit demands. In fact, they indicated satisfactory ability to meet an additional loan demand if that should occur.

Turning to the national picture, Mr. Irons said he did not see anything new in the picture that would call for an appreciable change in

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monetary policy. The question of a tax cut had now been settled for some months, and it might be well to wait and appraise the effects of that decision on business attitudes and reactions. The attitude of businessmen in the Eleventh District was favorable: they were not expecting a boom that would "go through the ceiling," but the economy was operating at record levels in most areas and they saw some further advances ahead.

In the circumstances, Mr. Irons said, he felt the situation was such as to justify continuing the policy of the past several weeks. All seasonal requirements for credit should certainly be met, and perhaps they should even be met liberally. On the other hand, he would not attempt to force reserves on the banking system at this time. In his view, free reserves of \$350-\$400 million, a Federal funds rate of 2-3/4 - 3 per cent, and a bill rate around 2.8 per cent would represent a satisfactory situation for the period ahead.

As to the policy directive, Mr. Irons said he would see no particular objection if the Committee wanted to take out the language relating to unsettlement in financial markets. However, he was inclined to feel that the Committee had been making too many minute changes in the directive, and he was not entirely sure that unsettlement no longer existed in financial markets. He would not favor a change in the discount rate at this time.

Commenting on the Eighth District, Mr. Francis said that business activity appeared to have leveled off since June following a moderate advance during the first six months of the year. For the past six weeks

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bank debits had remained at approximately the June level, interrupting a rising trend that had been evident since January. Business loans, which rose from March to June, remained virtually unchanged in July. Unemployment, as measured by compensation claims, showed little change. It appeared that District department store sales may have risen more than seasonally in July and early August.

The growth of bank deposits had leveled off, Mr. Francis said. After a slight advance in June, demand deposits continued their general decline, while time deposits continued to expand.

Cash farm receipts for the first half of the year were about 3 per cent above the first half of 1961. Crop conditions indicated that farm income would continue above 1961 levels during the remaining months of this year. Most crops were good to excellent, but pastures had been damaged rather severely by drought in the central Missouri area.

Mr. Latham reported that statistics were not sufficiently available with respect to New England to determine its participation in the improvement noted for the country as a whole in July. In general, however, New England business appeared to be relatively good. Although it had not measured up to expectations, it apparently had weathered the setback occasioned by the stock market decline and adverse economic forecasts.

Although District employment, production, and construction leveled off in June, preliminary reports suggested some renewed strength in July. Department store sales continued strong, with a 6 per cent increase reported for the four-week period ended August 11 compared with

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a year ago. Consumer income continued to show improvement. July employment figures for the State of Connecticut were generally favorable, both with respect to nonmanufacturing employment and average weekly hours of factory workers. (Connecticut accounts for approximately one-quarter of New England employment.)

Check clearings continued at abnormally high levels during June, July, and August, Mr. Latham said, averaging 8 to 9 per cent in number above a year ago. Total bank loans and investments, particularly investments in municipals, also continued at high levels. During the past three weeks, savings deposit growth had been at a 16 per cent annual rate. Both loan and deposit growth suggested a continuance of the present rate of growth of monetary velocity.

Mr. Balderston noted that the adverse over-all balance of payments continue to add to the dollar holdings of foreign central banks despite advance payment arrangements that could not be expected to continue, or to be repeated. Further, the trade balance was already as favorable as could be expected to obtain in the near future since European countries and Japan had been enjoying booms. It appeared, therefore, that the solution must be sought in this country's foreign spending, lending, and investing. That part of the spending and lending done by the Government clearly was not the responsibility of the Federal Reserve System. On the other hand, the part that represented the lending and investing of private funds was within the province of the System. The more bank credit the System provided, the greater was the tendency of American banks to

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make foreign loans and the greater was the tendency of foreigners to sell securities in this country's capital markets. In short, this country's liquidity seemed to be leaking beyond the confines of the domestic economy, thus adding to foreign holdings of liquid dollar assets.

To him, Mr. Balderston said, the problem seemed to be one of continuing to seek the optimal combination of international and domestic goals. On the domestic side he watched, like others, the money supply and its curious shifts. He also kept watching the extent to which banks resorted to the discount windows. When the banks became pressed to accommodate their customers, he assumed they would not hesitate to borrow more from the Federal Reserve Banks. Thus far, however, the increase had been minimal. On the international side, he had increasing concern because each month that passed without a solution of the basic problem--without achieving a sustainable over-all balance--seemed to bring closer the threat of crisis. Such a crisis, he added, would not be of foreign making alone. It would embrace and involve Americans who had funds they wished to protect. So he felt that with the passing months the Federal Reserve must give added weight to international goals in the combination it had been trying to achieve. If a confidence crisis should arise, he supposed it could be better handled if long-term rates were higher rather than lower.

In view of factors such as the imminence of the Fund and Bank meetings and the continual talk of irresponsible people concerning the dollar, Mr. Balderston said he found himself in rather complete agreement with what Mr. Treiber had said and what Mr. Wayne had added later. He would

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feel comfortable with continuation of a goal of about \$350 million of free reserves, because in this uncertain period he felt that the System ought to be in a position from which it could swerve in either direction. As to the directive, he found himself in accord with the suggestion made by Mr. Hayes at the July 31 meeting and repeated by Mr. Treiber at this meeting.

Chairman Martin commented that the majority of the Committee appeared to favor maintenance of the status quo, to which he added that personally he saw no reason to change the status quo at the moment.

As to the current policy directive, the Chairman indicated that he was rather inclined to agree with the view expressed by Mr. Irons. He was not sure that the unsettlement in financial markets had been completely eliminated. However, he had no particular feeling about dropping that reference if the Committee so desired.

Chairman Martin then repeated that he understood the majority view this morning was for maintenance of the status quo as far as policy was concerned.

The only dissents were indicated by Messrs. Mitchell and Bopp, both of whom stated that they wished to be recorded, for reasons they had given earlier, as not favoring maintenance of the status quo.

The Chairman then called for a poll of the nine members of the Committee who had expressed agreement with maintenance of the status quo, for the purpose of obtaining their views on the suggestion to eliminate from the directive the clause in the first paragraph relating to the

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unsettlement of financial markets and the clause in the second paragraph that called for open market operations to be consistent with the behavior of financial markets.

All of those nine members expressed themselves in the affirmative with respect to the suggested changes.

During the poll several comments were made. Mr. Mills, although indicating that he would be willing to go along with the deletion from the second paragraph, if that was the consensus, commented that the term financial markets had a much broader connotation than just the stock market. This term also touched on international exchanges and commodity markets--the whole range of areas in which the dollar was depressed. Mr. Balderston stated that he felt Mr. Mills had raised a valid point, while Chairman Martin stated that he went along with the deletions from the directive without too much enthusiasm.

Mr. Mitchell said he would like the record to show that in his opinion the directive was so loosely worded as to accommodate a great deal more latitude and flexibility than was reflected currently in the execution of open market policy. The directive was not inconsistent with the maintenance of the status quo nor was it inconsistent with the change in policy he advocated.

Mr. Mills made the comment that he was becoming more and more concerned about the Committee getting bogged down in words. It was his view that the Committee had gotten along better under the type of directive used prior to December 1961, which did not require attempting to express at each

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meeting some minor differentiation. Persons studying the policy record might read into such changes a meaning going beyond the actual intent of the Committee.

Chairman Martin replied that he saw considerable merit in that point of view. He recalled the amount of study that had been given to the formulation of the directive over the past several years and noted that the thinking with regard to the problem sometimes seemed to lead almost in a circle. He did not pretend to know the ultimate answer.

The Chairman then inquired whether there were other comments, and none were heard.

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

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

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

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Votes for this action: Messrs. Martin, Balderston, Bryan, Deming, Fulton, King, Mills, Shepardson, and Treiber. Votes against this action: Messrs. Mitchell and Bopp.

During Chairman Martin's appearance before the Joint Economic Committee on Thursday, August 16, Congressman Reuss made the following comment:

"I now ask my question: At your upcoming meeting next week of the Open Market Committee, will you please pass on to them my ardent request that they reconsider what they did on December 19, 1961, and hopefully go back to the sensible directive which they had in effect then and restore the free reserves of the banking system to at least the \$500 million level and do the part which I think the monetary authorities have to play in getting this economy moving forward again."

Chairman Martin had indicated in his reply that Congressman Reuss' comment would certainly be borne in mind. He wanted, therefore, to insert this into the Open Market Committee record.

Mr. Broida withdrew from the meeting at this point.

There had been distributed to the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period July 31 - August 15, 1962, together with a supplementary report for the period August 16 - 20, 1962. Copies of these reports have been placed in the files of the Committee.

Commenting in supplementation of the written reports, Mr. Coombs noted that foreign exchange markets had remained reasonably quiet since the date of the previous Committee meeting, with some improvement in the

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dollar rate against the Swiss franc and the Dutch guilder. Several factors had contributed to a noticeable, although possibly temporary, improvement in foreign confidence in the U. S. dollar. These included President Kennedy's Telestar statement, the announcement of improved balance of payments figures for the second quarter of the year, and the forestalling of potential gold losses through Treasury and System foreign exchange operations. The London gold market had been quieter recently.

Following a discussion of Treasury Stabilization Fund operations during the past three-week period, Mr. Coombs noted that the Federal Reserve System also had been active during that period. On August 2 the System liquidated its \$50 million swap with the Bank of France and replaced it with a standby swap in the same amount. On the same day the System entered into a \$50 million standby swap arrangement with the German Federal Bank. On August 7 the System used \$10.5 million equivalent of Belgian francs to purchase the equivalent amount of dollars from the Belgian National Bank in order to forestall a potential Belgian demand for gold. Also, on August 7 the System drew an additional \$10 million equivalent of Swiss francs from the Bank for International Settlements under its \$100 million standby agreement and used the francs to mop up "excess" dollar holdings of the Swiss National Bank and thus avoid a potential gold loss.

Further, a strengthening of the dollar rate against the Dutch guilder and a decline in the gold holdings of the Netherlands Bank had given the System an opportunity to accumulate Dutch guilders for the purpose of paying off System drawings under the \$50 million swap arrangement with the Netherlands Bank. Arrangements had been made with the

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Netherlands Bank to purchase guilders for System Account at market rates whenever such operations would not place downward pressure on the dollar spot rate vis-a-vis the guilder. Orders executed by the Netherlands Bank under this agreement had totaled more than \$10 million through yesterday. The Account Management would expect to utilize the guilders to pay off \$10 million of the \$50 million drawn under the swap, leaving \$40 million outstanding. It was hoped that the situation had now turned in favor of the dollar and that in the next month or so enough guilders could be bought back to liquidate the swap completely. If this worked out, it would provide another illustration of how official swap operations could be useful in offsetting or cushioning reversible flows of funds.

Mr. Coombs then commented that the Netherlands Bank had shown resistance to making direct deals with the Federal Reserve on a wholesale basis at market rates. As an alternative, it had offered to give the System a special and more or less arbitrary rate under the market. While the System would still make money on the deal if it accepted such an offer this would represent a deviation from the rules set forth in the Committee Authorization and Guidelines pertaining to System foreign currency operations, which called for operating at market rates in the absence of some special circumstances that would cause the Committee to decide to do otherwise. Mr. Coombs had indicated to the Netherlands Bank that he thought the Committee would have serious doubts about deals at a rate other than the market rate. He thought that the System could manage, in any event, to accumulate enough Dutch guilders to pay off the swap before maturity.

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It was his suggestion, therefore, that the System adhere to its position of operating only at the market rate and he would appreciate the Committee's views.

In reply to questions by Mr. Mitchell, Mr. Coombs said that the exchange rate was a true market rate at the moment. Although all central banks exerted an important effect on the rate by their decisions to acquire or release dollars, they tried not to frustrate basic tendencies in the market.

Mr. Mitchell then said that if one could be sure market forces were permitted to work and the exchange rate therefore reflected them, he would think there was a great deal to be said for hewing to the position of dealing only at market rates. On the other hand, if a central bank could and did regulate the market, there would seem to be little use in going along with a pretense.

Mr. Coombs reiterated that although central banks do intervene more or less continuously, they do not regulate the market. They attempt to smooth out seasonal and temporary factors so that the market rate will reflect basic forces rather than temporary disturbances.

Mr. Treiber pointed out that when the Open Market Account enters into purchases and sales of U. S. Government securities direct with foreign central banks, those transactions are executed at current market rates.

After further discussion it was the view of the Committee, with which no disagreement was indicated, that operations in foreign currencies

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for System Open Market Account should continue to be at market rates.

Mr. Coombs next pointed out that the dollar-sterling swap arrangement between the Federal Reserve System and the Bank of England would mature on August 30, 1962. He recommended liquidating the contract at maturity and placing the swap on a stand-by basis, which would be fully as useful as the present arrangement.

He also requested authorization from the Open Market Committee to reopen negotiations with the Bank of England with a view to increasing the amount of the sterling-dollar swap to as much as \$250 million. In earlier negotiations the Bank of England and the British Treasury were hesitant about going beyond \$50 million, but at that time the British still owned over one-half billion dollars on their drawing from the Monetary Fund. That drawing having now been repaid, the British might wish to reconsider a substantial enlargement of the swap facility, and Mr. Coombs felt that \$200 or \$250 million would be more appropriately in line with the size of potential payments swings between the United States and the United Kingdom. An arrangement of such size, he noted, would also make a significant contribution to solving the longer range problem of international liquidity.

In reply to a question regarding the rationale underlying the apparent preference for standby arrangements, Mr. Coombs said a foreign central bank might feel that it was of little use, in terms of a possible future emergency, to have a swap executed in advance. If there was a

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standby swap arrangement, and if it were drawn upon, the drawing would represent an addition to reserves at a time when needed. Mr. Coombs felt that this was a valid argument. Originally, he said, all of the swaps could have been put on a standby basis. However, the Account Management thought it would be well to test the machinery for investment. A lot had been learned, and the testing period had been completed without disadvantage to the Federal Reserve. Therefore, it seemed reasonable to move to a standby basis.

Mr. Mitchell inquired whether, if standby arrangements were on a three-month basis, this meant that actual implementation could not exceed the period for which the standby swap was arranged. Mr. Young commented, in reply, that this was a technical aspect of the standby arrangement that he felt could be worked out. If a standby swap was drawn against in substantial amount, it might be worked out that the arrangement could run for three-months from the time of the drawing.

Discussion then reverted to the suggested amount of the sterling-dollar standby swap arrangement, and Mr. Coombs reiterated that the British had not approached the Federal Reserve with regard to any possible increase in the amount of the swap facility. He felt, however, that a standby swap of the suggested magnitude would rebound to the benefit of both parties by buttressing the international financial system as it now existed and working toward improving the smoothness of its functioning. In all arrangements of this kind, there were both direct and indirect benefits. From the standpoint of the relative magnitudes of payments swings, Mr. Coombs suggested that a sterling-dollar swap of \$250 million might be compared

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roughly to a \$100 million guilder-dollar swap and a \$75 million Belgian franc-dollar swap. In the case of Swiss francs, the payments swings could be so large that he thought there might be a question whether \$200 million was really adequate. In short, the magnitude of potential payments swings was the vital point.

At the conclusion of the discussion, authorization was given by the Committee, without indication of disagreement, for negotiations with the Bank of England looking toward replacement of the existing \$50 million sterling-dollar swap with a standby swap, with the possibility of increasing the swap facility to an amount in the order of \$250 million.

In further discussion, Mr. Bryan referred to earlier comments by Mr. Coombs regarding the apparent success of Treasury and System foreign exchange operations in offsetting or cushioning several reversible flows of funds. He asked Mr. Coombs whether the latter thought this uniformly favorable experience could be expected to continue indefinitely unless the U. S. balance of payments problem was brought under control, and Mr. Coombs replied to the effect that if the balance of payments situation should deteriorate his judgment would tend to be in the negative.

Mr. Bryan noted that certain foreign witnesses who testified recently before the Joint Economic Committee had recommended giving gold guarantees, and he asked whether the swap arrangements entered into by the Federal Reserve could be said to give foreign central banks such a guarantee. Mr. Coombs responded that when President Hayes of the New York Bank appeared at the Joint Committee hearings and was asked such a question, Mr. Hayes replied that the System swap arrangements were selective

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short-term operations of a commercial type using an instrument, the forward contract, that is frequently used in exchange markets.

Mr. Furth noted that our swap agreements do not provide a gold or gold value guarantee--only a guarantee of the value of the dollar in relation to the currency of the other party, and vice versa. If the dollar were devalued against the guilder, for example, we should have to use more dollars to repay the Netherlands Bank; but if both currencies were uniformly devalued in terms of gold, that would not be the case. Thus, under the swap arrangements our liabilities would not be increased in the case of a uniform change in the price of gold in accordance with Article IV, Section 7, of the International Monetary Fund Agreement.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in foreign currencies during the period July 31 through August 20, 1962, were approved, ratified, and confirmed.

Chairman Martin noted the receipt of a letter addressed to him under date of August 14, 1962, by Congressman Wright Patman, Chairman of the Joint Economic Committee, with which Mr. Patman had transmitted a copy, in galley form, of an unpublished Joint Committee Print. As set forth in the letter, this document had been prepared by Dr. John G. Gurley, Professor of Economics at Stanford University, and Dr. Asher Achinstein, Senior Specialist in the Legislative Reference Service of the Library of Congress, at Congressman Patman's request. As received, it comprised a four-chapter, 74-page digest based on the minutes of the

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Federal Open Market Committee for 1960, which minutes had been transmitted to the Joint Economic Committee under date of July 21, 1961, at the request of Congressman Patman, with a letter from Chairman Martin which indicated that the Open Market Committee was making these minutes available to the Joint Economic Committee on the understanding that they would be treated as confidential.

Congressman Patman's letter stated that he had intended to take up with the Joint Economic Committee, after the Committee's present series of hearings was completed, the question of making this report public. The letter went on to say, however, that "it is apparent that a copy of the Gurley-Achinstein report has fallen into the hands of a newspaperman, as extracts from the report appeared in news items in the New York Times yesterday and again today, and possibly others will appear in the days to come." The letter added that this premature disclosure of the contents of the report in the press had raised the question of immediate release of the report to the press generally, and that the Joint Economic Committee had met and adopted by majority vote the following resolution:

"That the presently-confidential Joint Committee print, entitled 'How Policies of the Federal Reserve System Are Determined' be submitted in a letter by the Chairman to the Chairman of the Board of Governors of the Federal Reserve System with the request that he allow us to make it public because, in our view, the material in it is in the public interest and in the public interest it ought to be made public; that this be done promptly; and that until a resolution of the matter is had, the Joint Economic Committee print be held confidential."

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The letter stated that an early answer to the Committee's question would be appreciated.

Copies of Congressman Patman's letter and of the galley proof of the Joint Committee Print had been reproduced, and they were sent to the members of the Open Market Committee at Chairman Martin's request on August 16, 1962.

In introducing a discussion of the type of reply that the Open Market Committee might make to Congressman Patman, Chairman Martin noted that the question presented in the letter gave rise to a number of related issues that warranted serious consideration. Among other things, Chairman Martin referred to questions that had been raised over a period of time concerning the adequacy of the policy record of the Federal Open Market Committee as published in the Board's Annual Report each year, in which connection he noted that the adequacy of such record for the year 1960 had been challenged at the hearings held by the Joint Economic Committee in June 1961, following which Congressman Patman requested that the Open Market Committee's full minutes for the year 1960 be made available to the Joint Economic Committee. Chairman Martin also pointed out that the question of adequacy of the policy record was closely related to the continuing efforts of the Open Market Committee to devise the most suitable form of policy directive to the Federal Reserve Bank of New York.

Turning to another phase of the matter, Chairman Martin recalled that on various occasions, once only recently, the Open Market Committee had given consideration to the possibility of publication in full of the

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Committee's minutes for some past period. Thus far, he noted, that question had not been resolved. He did not propose that it be reopened at today's Committee meeting, but it should have further consideration.

In the discussion that followed, comments were made to the effect that the short time available since distribution to the Committee members of the Joint Committee Print had not permitted careful study of the document by the Committee members. It was noted, also, that the galley proof referred at one point to a final chapter of the report that was not contained in the copy received by Chairman Martin from Congressman Patman. The suggestion was made, therefore, that it would seem desirable to ascertain whether such a final chapter was proposed to be included in the Joint Committee Print; and that, if so, it would seem appropriate for such chapter to be made available to the Open Market Committee for review before a substantive reply was made to Congressman Patman's letter.

In view of the foregoing and other considerations, it was suggested that Chairman Martin make an interim reply to Congressman Patman, in which it would be pointed out that more time was required to consider carefully the question presented in Mr. Patman's letter and that, in the circumstances, the Open Market Committee had concluded that it would be desirable to carry over that question until its next meeting, to be held on September 11, 1962, following which the Open Market Committee would advise the Joint Committee of its views. The letter would also inquire concerning the Joint Committee's plan to include an additional chapter in the Print, with the statement that it would be

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helpful to the members of the Open Market Committee, if the Joint Committee planned to include such a chapter, to have an opportunity to review the galley proof thereof.

At the conclusion of the discussion, it was the consensus that Chairman Martin should make an interim reply to Congressman Patman along the lines that had been suggested. It was understood that between this date and the date of the next Open Market Committee meeting, scheduled for Tuesday, September 11, the members of the Open Market Committee would give further study to the question presented in Congressman Patman's letter and to the related questions of Open Market Committee practice and procedure raised thereby, with a view to deciding at the September 11 meeting what type of further reply should be made to Mr. Patman. In this connection, Chairman Martin noted that in the interim members of the Committee could, if they wished, submit comments with regard to various phases of the matter.

Secretary's Note: Pursuant to the foregoing understanding, the following letter was sent by Chairman Martin to Congressman Patman under date of August 21, 1962:

"This refers to your letter of August 14, 1962, transmitting a copy of a proposed Joint Committee Print entitled 'How Policies of the Federal Reserve System are Determined' and quoting a resolution adopted by your Committee to the effect that this Print be submitted to the Chairman of the Board of Governors of the Federal Reserve System with the request that your Committee be allowed 'to make it public.'

"In my letter of July 21, 1961, transmitting to your Committee the minutes of the Federal Open Market Committee for 1960, there were set forth in some detail the reasons for which the Open Market Committee is convinced that the public interest would not be served by publication in whole or in part of

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"detailed minutes of meetings of the Committee. The question whether it would be in the public interest to publish the Joint Committee Print which purports to contain an analysis and condensation of those minutes obviously involves considerations that require careful study by the members of the Open Market Committee.

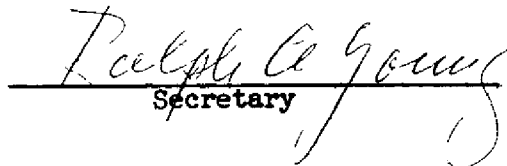
"Upon receipt of your letter, I immediately had the copy of the document transmitted by you reproduced and distributed by air mail to each member of the Open Market Committee. However, the members of the Committee did not receive copies of the Report in time for more than cursory reading before the regular meeting of the Open Market Committee today (August 21, 1962).

"Moreover, the last paragraph of Chapter I of the Report appears to indicate that a last chapter of the Report has the purpose of highlighting 'the main points brought out by the minutes with respect to the actions of the Committee in 1960,' and of briefly discussing 'them from the point of view of the achievement of a more effective monetary policy.' Yet, the Joint Committee Print in the form enclosed with your letter does not include such a final chapter. If it is your Committee's plan to include such a chapter in the proposed Print, it would be helpful to the members of the Open Market Committee also to have an opportunity to review the galley proof of that chapter.

"For the reasons here indicated, the Open Market Committee at its meeting today concluded that it would be desirable to carry over until its next meeting, to be held on September 11, the question raised in your letter concerning general publication of the proposed Joint Economic Committee Print. Promptly following that meeting, you will be advised of the Committee's views."

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, September 11, 1962.

The meeting then adjourned.


Secretary