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, September 11, 1962, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Bryan
Mr. Deming
Mr. Ellis
Mr. Fulton
Mr. King
Mr. Mills
Mr. Mitchell
Mr. Robertson
Mr. Shepardson

Messrs. Bopp, 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. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hexter, Assistant General Counsel
Mr. Noyes, Economist
Messrs. Brandt, Brill, Furth, Garvy, Hickman, Holland, Koch, Parsons, and Willis, 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. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Broida, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors

Mr. Francis, First Vice President, Federal Reserve Bank of St. Louis
Messrs. Eastburn, Baughman, Tow, and Coldwell, Vice Presidents of the Federal Reserve Banks of Philadelphia, Chicago, Kansas City, and Dallas, respectively
Messrs. Parthemos and Arlt, Assistant Vice Presidents of the Federal Reserve Banks of Richmond and St. Louis, respectively
Mr. Sternlight, Manager, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 21, 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 August 21 through September 5, 1962, and a supplementary report covering the period September 6 through September 10, 1962. Copies of both reports have been placed in the files of the Committee.

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

The money market in the past three weeks has maintained a moderately firm tone, with Federal funds trading at 2-3/4 and 3 per cent throughout the period. The effective rate was most often at 3 per cent, although a good volume of funds moved at 2-3/4 per cent even on most of those days when the heaviest trading was at the 3 per cent level. Member bank borrowing, meanwhile, has been generally moderate.

Notwithstanding this situation in the money market, three-month bill rates have hovered around 2.80 per cent, while six-month bills have remained under 3 per cent. There was a substantial corporate demand for bills in the early part of the period, but this tapered off to some extent around the Labor Day week end. This demand, however, was vigorously reasserted after the Treasury announced its advance refunding and corporations began to switch out of rights and into bills in an effort to capture the attractive premium to which the rights moved in reflection of the generous yields offered by the Treasury in the refunding.

Developments in the bill market were a factor influencing the approach to System operations over the period, although of course the general direction and magnitude of those operations was shaped primarily by the need to offset large seasonal movements in reserve factors and to preserve a steady market atmosphere with the advent of the Treasury's operation. Thus, in the early part of the interval, when reserves were being supplied to meet month-end and pre-holiday drains, funds were injected mainly through purchases of short- to intermediate-term coupon issues, through repurchase agreements, and through purchases of bills directly from foreign accounts. In the last few days, with market factors providing funds, the System has absorbed reserves through the termination of repurchase contracts and sales of bills to foreign accounts. Moreover, we arranged in yesterday's bill auction to run off $203 million of bills maturing this Thursday, thus in effect augmenting the market supply of bills.

For the next week or so, as indicated in the reserve projections attached to our supplementary report and also to the Board staff's memorandum on reserves, free reserves are expected to bulge quite substantially--even after giving effect to the run-off of bills that I just mentioned. This appearance of over-ample reserve availability may be a bit illusory, however. We are now experiencing the mid-September bulge in liquidity needs as corporations seek to acquire cash to pay dividends and taxes; and superimposed on these seasonally heavy liquidity requirements is a burgeoning of dealer financing needs as dealers acquire rights to the Treasury's advance refunding operation. Yesterday, for example, dealer financing needs were over 1/2 billion dollars--most unusual for a Monday. All this suggests that if the Committee should wish to see about the same market conditions maintained, a somewhat higher level of free reserves may well be necessary, for the next week or two, to maintain those conditions; to put it the other way, the maintenance of recent free reserve levels over the next week or two could well result in substantially tighter market conditions than we have experienced in some time.

The long-term market has behaved quite steadily in the recent period, losing some of the buoyancy that carried prices up during much of August but retaining an underlying tone of confidence. The market apparently feels that while interest rates will of course fluctuate in response to day-to-day developments, a decisive move in rates one way or the other is not a likely prospect. In this atmosphere, it appears that the Treasury's advance refunding, for which the subscription books close tomorrow, is being well received. Highly tentative and preliminary guesses as to the amount of rights that will be exchanged center around $5 - $7 billion.

> The System holds a little over $7 billion of the rights. I do not, however, propose to exchange any of those holdings.
>
> I should mention to the Committee that the Account has had to be reallocated four times since the beginning of July, and three times in the past three weeks, owing to the reserve ratios of individual Reserve Banks falling below 30 per cent. With the seasonal rise in note and deposit liabilities about to get under way, and with the possibility that we may experience further gold losses, we may well have to reallocate with increasing frequency in the months ahead. I have discussed this with the Board staff, and we are in agreement that under these circumstances it may be necessary to suggest to the Committee, in the relatively near future, that the ratio at which the Account shall be reallocated be reduced from 30 to 28 per cent.

Mr. Mitchell noted that the volume of capital market financing had been relatively moderate. He asked the Account Manager whether expectations of some future easing in the long-term rate might be a factor or whether the moderate volume of borrowing appeared to reflect primarily a lack of demand for funds.

Mr. Stone replied that the demand for new capital appeared to be relatively light. The level of rates in the past week or two was beginning to bring forth some refunding issues, but this had not built up to any substantial proportions.

Mr. Mills inquired whether any study had been made of the composition of the Open Market Account, particularly whether the holdings of bills were sufficient for the System's needs looking to the future. He also inquired whether the amount of bill holdings was compatible with the total of outstanding short-term Government securities.

Mr. Stone replied that he was not aware of any formal study as to what would constitute an ideal maturity structure for the System portfolio. However, holdings of bills were about $3 billion, with the

end-of-year seasonal rise still ahead of us. Earlier this year, System holdings of securities maturing within one year amounted, as he recalled, to between $16 and $18 billion, which meant that it would have been possible to absorb virtually all of the reserves in the banking system without selling maturities beyond one year. In his opinion the Account was amply liquid.

Mr. Mills then commented that with a growing Federal debt and a growing effort to introduce liquidity throughout the economy, he had been wondering whether holdings of $3 billion in bills were sufficient to provide a fulcrum for carrying out System policy, particularly where there was so little inclination, or ability, to divest long-term securities that the System had acquired.

Mr. Stone reiterated that in his opinion short-term holdings of the System Account, particularly holdings of bills, were quite ample.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities during the period August 21 through September 10, 1962, were approved, ratified, and confirmed.

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

> It would appear that optimism about economic prospects engendered by the July statistics may have to be tempered as the August results come in. It is too early in the month for a complete picture, but the fragments in to date don't suggest any follow-through on the relatively strong performance in July. In fact, in some areas there were setbacks, with the unemployment rate up sharply and employment down; in others, such as industrial production, retail sales, and private construction expenditures, there was a levelling off or some downdrift.

The unemployment figures have by now been widely reported, and to a large extent discounted in terms of special factors operating during the period when the survey was taken--concentration of model change-overs in the auto industry, inclusion of prospective teachers awaiting opening of the school term, and so forth. Suspect as the increase in the unemployment rate may be, however, it needs to be borne in mind that more comprehensive data on employment--the employer reports of the Bureau of Labor Statistics--showed some decline last month, and the average work week in manufacturing drifted off again for the fourth consecutive month. All in all, perhaps the safest conclusion to draw from recent labor force and utilization data is that the improvement earlier in the summer and the more recent retrogression both represented rather random jiggles around a plateau.

Similarly, advance reports on August retail sales from the Department of Commerce show a reaction from the July spurt, confirming earlier indications of our own department store statistics and the weekly data on auto sales. July apparently was even better than the early reports, but in August total sales showed a small decline. Private construction expenditures were also down last month.

The up and down movements in the economy this summer have been characteristic of the uneven pace of the whole recovery-expansion period. Months of rapid advance have alternated with periods of slow rise, or even of slack, but on net, growth since the beginning of the year has been modest, particularly in contrast to the 10 per cent annual rate of rise during 1961.

Previous postwar cycles have also shown a marked slowing in expansion after four or five quarters of vigorous growth. Thus, both industrial production and real GNP showed only a slight further rise in the long interval from late 1955 to the summer of 1957. In the 1958-60 recovery, which was both brief and distorted by the steel strike, output was little higher at the upper turning point in the spring of 1960 than it had been the year before.

Looking back to even earlier cycles, shortages of manpower and of industrial capacity may have been important elements in the slowdowns in expansion after initial run-ups. In recent years, however, when resources have been ample even at cyclical peaks, it appears to have been the demand--rather than the supply--side which has limited expansion in output and declines in unemployment. Currently, demand forces again appear to be the main constraints on output. With substantial unused capacity, it is not surprising that business plant and equipment outlays are not scheduled to increase much further this year. It is too early, of course, to expect that the recent liberalization of depreciation rules would produce significantly higher spending plans, and it is perhaps reassuring that businessmen, by and large, are not trimming sights as a result of stock market developments or sluggishness in final demand. Nevertheless, the latest survey of businessmen's plans indicates that

this key area of economic demand will be providing little further lift to the economy over the balance of the year.

Inventory policies also continue cautious, reflecting the ample supply and capacity situation. The latest survey of manufacturers' inventory anticipations suggests a continuation for some time of only a moderate rate of restocking.

Surveys of consumer buying plans do not hold out the prospect of substantial lift from this sector either. Housing starts--and residential construction activity in general--are already down from their spring highs. While auto sales have generally been at advanced levels, the most optimistic of industry forecasts for 1963 is no higher than prospective sales of the 1962 models.

In summary, "sluggish" remains the most apt description of the economy's recent and prospective performance. Monetary ease alone may not be a sufficient condition to move the economy from its apathy, but it is a necessary support to any other stimulative force. Considering the slack in resource utilization, the stability of prices in markets for industrial goods and equities, and the general absence of symptoms of inflationary expectations, it would appear appropriate to provide a financial climate in which the banking system is able--indeed anxious--to accommodate the financing and liquidity needs of business and consumers.

Mr. Koch presented the following statement on credit developments:

Since this is the first opportunity I have had to talk to this Committee for some time, I shall look at financial developments over a somewhat longer time span than just the three-week interval since your last meeting.

First, looking at bank credit, this is an area where one who feels a stimulative monetary policy is appropriate can currently get some encouragement, at first glance at least. Seasonally adjusted total loans and investments at all commercial banks increased about $2-3/4 billion in August, though after a large decline in July. The seasonally adjusted annual rate of rise in bank credit thus far this year has been 7-1/2 per cent.

Moreover, in August there was considerable strength in business and real estate loans, dynamic areas of bank lending that are usually associated more directly with spending and investing than some other areas. In business loans, the rise was in heavy industries, like metal producing and fabricating lines, and public utilities, and not only in the soft goods and seasonal lines.

Business loan growth in the last two weeks, however, has been much less vigorous, and it is still too early to say whether the August strength was a flash in the pan or an early indicator of the fall trend. Capital market financing, in contrast to bank financing,

has been weak all summer, and the September calendar of prospective new issues is particularly light. There is also the question as to what proportion of the bank credit growth thus far this year has represented the investment of savings rather than money creation, and it is this question to which I should like to turn.

Looking at the liquidity creation function of monetary policy, a function, it seems to me, that must be given as much weight as the credit availability function, the news isn't so good. As a matter of fact, the most current news is quite disturbing. The narrowly defined money supply may have decreased about $800 million in the last half of August. Currently, it is about 1 per cent below the level at the end of last year.

Also disconcerting in recent weeks, in view of the sluggish demand deposit performance, has been a marked slowdown in the rise of time and savings deposits of commercial banks. In the first half of the year, these deposits had risen at a seasonally adjusted annual rate of about 20 per cent, but recently the rate of rise has fallen to about 10 per cent. In the 18 months prior to the revision of Regulation Q, these deposits had risen at an annual rate of about 14 per cent.

But how could bank credit growth have been quite satisfactory and private deposit growth so disappointing in August? The answer lies mainly in the continued very large level of Treasury balances. These balances have been running much higher than usual all summer. In the last half of August they averaged over $8 billion, whereas they normally run $2 to $3 billion less.

The question naturally arises as to whether some allowance should be made for the sharp growth in time and Treasury deposits since the first of the year in assessing the effectiveness of our recent money creating job. To state my conclusion before its support, I believe some allowance should be made in the case of time deposits but not in the case of Treasury deposits. My reasoning is as follows:

Consider, first, the excess in the rate of growth in time deposits thus far this year over the rate prevailing last year prior to the change in Regulation Q. Making the admittedly arbitrary, but perhaps as good as any alternative, assumption that half of this excess came from demand accounts and, therefore, should still be counted as demand deposits for purposes of comparability, this year's rate of growth in the money supply would be increased from about minus 1 to about plus 1 per cent.

I base my view that no allowance should be made for the continuing high level of Treasury deposits in assessing the adequacy of the money supply on two observations. In the first place, the amount of Government spending is obviously not materially affected by the size of its cash holdings, and secondly, the Government presumably had to borrow more and hence drain funds from the market to the extent that it has accumulated any temporarily excess deposits. We may get some flow back from Treasury to private deposits in October, in which case it seems to me we should be careful not to absorb too aggressively the reserves released by any decline in Treasury balances that may occur.

Thus, I conclude that the effective money supply, using as comparable concepts as possible at the beginning and end of the period, could not have gone up more than at about a 1 per cent seasonally adjusted annual rate thus far this year. Now this rate is somewhat more reassuring than a small negative rate, but it is still considerably less than the 5 per cent annual rate of increase in GNP that has occurred over the same period.

I can be much briefer when it comes to the reserve indicators of recent policy, for they show much the same story as the money supply figures. We have now dropped to over $200 million below our required reserve guide; that is, the guide that allows for a 3 per cent growth in required reserves behind private demand and time deposits. Free reserves have fluctuated around $400 million, although they would have averaged somewhat lower had it not been for a late downward revision in the required reserves of country banks that affected the figures for two of the three weeks since the Committee's last meeting.

So much for the question of what have been the effects of recent monetary policy. I think enough facts are now in for us to begin to consider very seriously whether recent monetary policy may not actually have been something of a damper rather than a stimulus to economic expansion. Treasury financing activities in progress and in prospect may preclude our doing much about it in the immediate future even if we wanted to, but when the opportunity arises, I feel a somewhat easier monetary policy would be highly desirable. I say this even though my own view is that the more basic need for stimulation lies in the area of longer run fiscal policy rather than shorter run monetary policy.

The two main objections usually given to increasing monetary ease even slightly are the adverse balance of payments position

and the possible impetus it might give to speculative activities that may be developing in the economy, for example, in the real estate area. I cannot add to the intelligence on the international financial situation except to express my own judgment that the basic balance is improving, albeit not very fast. But I also feel that a more satisfactory rate of economic growth is essential to the achievement of a solid and sustainable international balance. As to speculative activities in particular sectors of the economy, they do not appear to me to be widespread. In any event some loosening of lender standards probably has to be expected to accompany monetary ease, particularly prolonged ease. Unless we are willing to see the whole economy adversely affected, or to adopt selective controls, we must expect to see--but guard against as best we can--some excesses in lending on marginal types of economic activity. Here too, appropriate tax reform may be a more appropriate response than less credit ease.

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

The international economic scene has not changed since mid-August. In August the deficit in our balance of payments still was probably about $400 million, half of it due to the continuing reflux of funds to Canada. Preliminary figures for the last week of August and the first week of September suggest substantial improvement, but it is too early to judge whether these figures can be taken as indicating a new trend. In any case, the position of the dollar in major exchange and gold markets is on the whole much better than the size of our deficit would suggest.

The most disappointing aspect of our July deficit was the fact that it apparently was due to a deterioration in our basic accounts, including a drop in our exports and in our trade surplus of about $150 million.

In major exchange markets, the dollar remains weak against the Canadian dollar, the French franc, and the Italian lira. It remains close to par against the pound sterling and the German mark, and below par but above the bottom against the other major European currencies. These relations conform to the payments position of the countries involved. Canada, France, and Italy continue to gain reserves, but other major countries did not register substantial gains, and in some cases had net losses. Even for Canada and Italy, the gains might prove temporary: for Canada, because the reversal of the outflow of funds that had

occurred during the last quarter of 1961 and the first half of 1962 is believed to be nearing completion; for Italy, because of the approaching end of the tourist season. In fact, the last days of the past week have, for the first time in many months, seen no further rise in Italian dollar holdings. This would leave France, which in August for the sixth month in a row increased its reserves by an adjusted sum in excess of $120 million, as the main chronic surplus country.

In the London gold market, the price continued to move narrowly around $35.12, but apparently without net sales by the Bank of England. The net drain on the U.S. gold stock resulting from the latest flurry in the market, which began three months ago, has been only $64 million. Of this sum, $14 million was transferred to the Bank of England last week. The only further gold transaction in prospect is a sale of $30 million to Spain, scheduled for some time this month. This will bring the amount of gold sold to Spain since the beginning of 1960 to $425 million--all of it presumably paid for out of the financial aid we are giving to that country for defense and development purposes.

In response to a question, Mr. Furth said there did not seem to be any substantial outflow of short-term capital at present. In July the reflux of funds to Canada seemed to reflect primarily a reversal of the so-called leads and lags in commercial payments rather than a flow of short-term capital. In the past few days the covered interest rate differential between Canada and the United States had exceeded 1/2 per cent, the point where significant flows of funds usually start. Thus far, however, there seemed to have been no significant covered flows to Canada, apparently because of the imminence of the September 15 tax date. Yesterday the covered rate differential was .8 per cent, and the uncovered differential was much greater, running to 2 per cent or more. One reason for the lack of a flow of funds might be the narrowness of the Canadian bill market.

Mr. Hayes noted that there was in prospect a sizable flow of long-term funds to Canada because of the expectation of large private financing. This might be in the order of $250 million in the next three months.

Mr. Stone reported having been informed yesterday that $125 million of that amount would move on the fifteenth of October.

Mr. Hayes then presented the following statement of his views on the economic outlook and monetary policy:

> The domestic business situation continues its modest upward progress, although this trend is of uncertain strength. In July industrial production, nonfarm employment, personal income, retail sales, and new orders for durable goods all increased; and in our view early signs suggest no basic change in the over-all economic picture in August. To some extent, of course, the improvements merely reflect the removal or lessened influence of special factors that had depressed the June figures. Private spending plans--those of consumers and of businessmen--have been maintained despite the steep stock market decline in May and June and the tendency that one might have expected to postpone spending and investment decisions because of the uncertainties in the business and fiscal outlook.
>
> There is little change in the price picture. While the consumer price index continues its upward drift, there has been practically no change in industrial wholesale prices or sensitive raw material prices.
>
> We still have a good distance to go in our endeavor to make fuller use of men and machines. The August figures for employment, unemployment, and hours worked are quite discouraging.
>
> The liquidity of the economy remains adequate. While the private money supply (seasonally adjusted) has shown little change for several months, in the months to come disbursements from the unusually high Treasury balances are likely to add to the supply.
>
> Unfortunately, we still face a serious balance of payments problem. About half of the very large July-August deficit is due to the sharp improvement in the Canadian payments position and the resultant return flow of funds to Canada. While for this reason the two-month deficit is not so alarming as it

would otherwise be, it is still much too large. On the other hand, it is encouraging to note that the dollar has been fairly strong in European exchange markets, except against the French franc and the Italian lira.

Quite aside from short-term capital outflows, long-term lending by domestic financial institutions to foreigners, direct investments abroad, and the purchase of foreign securities on original issue have been high. For some of the New York banks, over 70 per cent of their total foreign loan portfolio is in term loans. Relatively low interest rates here, together with the greater availability of funds in this country, continue to place more dollars in the hands of foreign holders.

Federal Reserve policy continues to be one of relative ease. In my opinion greater ease would not provide a significant stimulus to our domestic economy. While the international situation might point to the desirability of a less easy policy--and of course particular attention will be focused on this aspect at next week's gathering of finance ministers and central bankers from all over the world--such a move is probably precluded, for the time being, both by the uncertainties of the domestic economy and by the current Treasury advance refunding program, i.e., by the need for maintaining an "even keel." Thus we should, I believe, maintain the status quo.

Specifically, it would seem appropriate that both the Federal funds rate and the three-month bill rate continue in the 2-3/4-3 per cent range, with both rates preferably in the upper part of the range much of the time. With maintenance of the status quo as a goal, I see no reason for any change in the directive, nor for considering any change in the discount rate at this time.

Mr. Ellis reported that New England economic indicators seemed to reflect no decisive trend. In July there was some seasonal decline in factory employment partially offset by growth in nonmanufacturing employment, and there had been a slight shift in the labor force tending to greater unemployment, this being in line with the experience nationally. In New England, counter to the national trend, there was a gain in average factory hours in July to a level higher than in any previous month, except one, since 1956. Should this trend continue, it might

portend gains in manufacturing employment rather than further gains in weekly hours. If the new orders index was indicative, there might be some broad upturn in production in the next few months because the index showed some strength. However, the manufacturing index registered a 1/2 point decline in July. The Reserve Bank's recent follow-up survey of capital expenditure plans indicated a slight upward revision of 1962 outlays. Consumer spending in August showed a slightly lesser rate of gain than previously, and the use of consumer credit had slowed down. The consumer credit index in August was below the year-ago level, with no change from July to August.

First District banks were experiencing a strong and steady business loan demand. Weekly reporting banks had had a strong seasonal runoff in demand deposits; this, coupled with the strength of loan demand, had caused them to resort heavily to the Federal funds market during the past several weeks. Unless loan demand should slacken or deposits rise, loan-deposit ratios were going to reach a postwar peak.

Turning to policy, Mr. Ellis saw no reason for not maintaining an even keel during the period of the Treasury advance refunding. Looking further ahead, the Committee continued to face a choice of less ease, no change, or greater ease. It seemed difficult to him to substantiate a case for less ease. The warning signals were flying for a business downturn next year; industrial prices were stable and employment was too low. Only in the event of an international monetary crisis would it seem desirable to lessen the prevailing degree of ease. On the hand,

he found it hard to accept the view that monetary policy had exerted a dampening effect on economic growth in recent months, and difficult to build a good case for a materially greater degree of ease. While the arguments made today and at the July 21 meeting were persuasive to a degree, he could not convince himself that the availability of more money would stimulate spending. As he had just reported, while money was available to consumers in New England, they did not choose to go further in debt in August. Business firms reported no difficulty in securing credit for their operations, and Mr. Stone reported a light capital financing calendar. In these circumstances, it was hard to believe that sufficient credit was not available in the economy, and a position of no change in System policy was attractive to him. Such a policy would, of course, involve considerable activity in meeting seasonal needs for reserves, and it would be important not to fall into inadvertent tightness in the next few months. In fact, he felt that the System should supply reserves somewhat in advance of seasonal needs, although with an eye to the impact on short-term rates.

As to free reserves, Mr. Ellis said he would favor a target of around $400 million, with reserves supplied on a basis that would accommodate a growth trend at an annual rate of about 3 per cent. The short-term bill rate should be around 2.80 per cent. He saw no reason for a change in the discount rate or the policy directive at this time.

Mr. Irons reported that in the past month there had been few significant economic or financial changes in the Eleventh District. Most sectors showed rather insignificant pluses or minuses, revolving around very high or near-record levels. Banking figures showed small decreases, although a generally satisfactory demand for loans was reported by city banks. Borrowing from the Reserve Bank continued to be negligible. Average sales of Federal funds had increased, thus reducing the margin between purchases and sales. On the whole, the District's banking position seemed to have moved toward a little more ease in the past month.

Mr. Irons said it was his feeling, in the light of developments in the domestic economy as well as the international situation, that present policy should be continued. He would favor open market operations designed to aim for free reserves in the area of $350-$400 million, a Federal funds rate in the 2-3/4 - 3 per cent range, and a bill rate around 2-7/8 per cent, give or take a few points. In summary, his recommendation would be substantially the same as that of Mr. Ellis. He saw no reason to change the discount rate or the directive.

Mr. Irons also said he was not inclined to believe that there was inadequate liquidity or that bank reserves were insufficient to meet any requirements that might reasonably be expected. He would supply reserves for seasonal purposes and perhaps even tend a little toward the side of ease if doubts should arise. Essentially, however, he would favor maintenance of the status quo over the next three weeks.

Mr. Swan said the situation in the Twelfth District reflected little change from his description at the August 21 meeting. Data for August were not yet available to any extent, and he would simply make one or two observations that seemed characteristic of District trends. Weekly figures on department store sales through August did not seem to show any particular increase from June and July. One major labor market area (Spokane) had been reclassified from substantial to moderate unemployment, leaving only three major areas in the District in the category of substantial unemployment. All of these were in California. San Diego was by far the most important, and because of the situation in aircraft it was the only one showing no improvement. In fact, the situation in that area had worsened over the past year.

Even with smaller acreage the prospect was for near-record crops in the District, close to the 1959 output. In the canning industry there was a large carryover as well as a substantial pack this year. Thus, it appeared that canned fruits and vegetables would be in near-record supply, with the expectation that some price weakening might develop.

Mr. Swan also reported that during the three weeks ended August 29 there had been a considerable increase in loans of weekly reporting member banks, with commercial and industrial loans sharing in the rise to a considerably greater extent than earlier. Real estate loans also increased. The major banks of the District had been substantial net sellers of

Federal funds in the past three weeks, and borrowings from the Reserve Bank had been small.

Turning to the national economic picture, Mr. Swan commented that developments were still far from decisive. The August increase in commercial and industrial loans had not lasted long enough to be sure whether it was more than a seasonal rise. In the circumstances, his views continued to be much the same as he had expressed previously. In terms of the domestic situation a modest easing of policy would seem justified, and he felt that this could be done without violence to the international position of the dollar or even the current Treasury refunding. Therefore, he would recommend a target for free reserves of $400 million or above, a bill rate of 2.80 per cent or slightly less, and a Federal funds rate of 2-3/4 per cent with more regularity than recently.

It seemed to him, Mr. Swan said, that the System should be careful to meet fully the seasonal needs for reserves, not only in the period immediately ahead but over the next several months. The System should not get itself into a position where market forces representing no more than seasonal factors were allowed to tighten the situation. He would recommend no change in the discount rate and no change in the policy directive.

Mr. Deming said there was nothing particularly new to report for the Ninth District; the same trends that had been noted earlier continued. As he had mentioned at the August 21 meeting, figures on

bank loans for early August indicated a strong expansion for that month after some softening of demand in July. The final figures bore out this estimate. City bank loan growth in August was larger than in any other August since 1955, with business loan growth particularly strong. At country banks, loans declined somewhat less than last year, but more than in other recent years.

With respect to the national economy, Mr. Deming agreed that the proper adjective to use was "sluggish," but he noted that it still modified the noun "advance." He would like a different adjective, but he saw nothing in the picture at the moment to suggest that there would be a change. Neither did he see, however, much likelihood that the noun would change in the foreseeable future.

Mr. Deming expressed interest in Mr. Koch's analysis. While he was not sure that he would weight the time and Government deposit figures just as Mr. Koch did, the latter's analytical approach did tend to bring into sharper focus the question of central bank action in relation to monetary liquidity. More work should be done on this question.

At the same time, Mr. Deming continued to believe that the general level of liquidity and of bank liquidity was adequate, and that the current rate of bank credit expansion was satisfactory. Total deposit growth remained impressive and recent interest rate behavior gave no indication of any particular tightness; in fact, it might be taken to imply a bit more ease in the markets than was true three or four weeks ago.

Given the current character of the national economy, Mr. Deming saw no reason to make monetary policy less easy. He would not want to have System actions inhibit in any way a further growth in bank credit, and particularly in bank loans, which now seemed to be running a bit better. Thus, he would agree that seasonal demands for reserves should be met generously. Perhaps the System should slightly anticipate those demands and furnish reserves a bit before they were seasonally needed.

The foregoing, Mr. Deming brought out, was a suggestion for a policy posture for a somewhat longer period than the next three weeks. For the period immediately ahead, he believed "status quo" was the proper policy. But, as pointed out by Mr. Stone, status quo should be measured more by tone and color, by short rates and Federal funds and borrowings, than by free reserve levels during this next three weeks. Specifically, he would try to keep about the same tone and color, and he would not be much concerned if free reserves ran significantly higher than the $350-$400 million level that had been prevailing. Given this prescription, he saw no reason to change the directive or the discount rate.

Mr. Scanlon reported that business sentiment in the Seventh District seemed a little brighter, not so much because of any pronounced improvement in the underlying trend but apparently because there was little evidence of the general deterioration anticipated in some quarters in July and early August.

However, the area would be seriously affected by the shutdown of the Chicago North Western Railroad should the strike continue much longer. Most of the important manufacturing centers in Wisconsin are heavily dependent upon this line, as are some localities in Iowa and Illinois. Secondary layoffs had already been announced by manufacturing and mining firms and grain handlers, and he had been told that other cutbacks could be expected to follow shortly. October would be a crucial month for agricultural areas dependent upon the North Western because of the large quantities of grain and livestock customarily moved at that time, so the timing of this strike was significant. Aside from the effects of this tie-up, employment in the District appeared to be following seasonal patterns.

All automobile manufacturers were now producing 1963 models, Mr. Scanlon noted. Dealers were liquidating 1962 models rapidly, and it was estimated that inventories at the end of September would total 740,000, which would include only 250,000 1962 models. As a result, there was a conspicuous absence of vigorous sales promotions to make way for new models. This was the time of year for Detroit auto analysts to forecast next year's sales and, as today's Wall Street Journal indicated, estimates ran from 6.2 million to 7 million.

Home building continued to be slow in most Seventh District areas, well behind the national pace, and business loan demand at District banks in recent months had not kept pace with the rest of the nation.

In view of the continuing moderate pace of business activity, the lack of strong credit demand, and the Treasury financing, Mr. Scanlon recommended no change in monetary policy at the present time. Like Mr. Deming, he would not worry about the free reserve figure in accomplishing this end. He would not change the discount rate or the directive.

Mr. Clay noted that latest information on the domestic economy indicated that the basic situation remained essentially unchanged. The two most important pieces of recent evidence were the reports on unemployment and on business capital outlays, both of which underscored the problem of inadequate resource utilization. With the unemployment ratio rising and the projected pattern of business capital spending showing no improvement, the need for a higher level of economic activity continued to be quite clear.

So far as domestic economic considerations were concerned, Mr. Clay said, monetary policy ought to be more expansive, with a moderate downward movement of interest rates all along the line. Because of international balance of payments considerations, however, the Treasury bill rate probably should be maintained within the range of the past three weeks. Whatever Treasury bill rate level might be determined to be necessary for international purposes, open market operations should be conducted with a view to producing some further reduction in longer term interest rates and to providing the reserves necessary for bank

credit expansion on a seasonally adjusted basis. No change was recommended in the Reserve Bank discount rate.

Mr. Wayne reported that, as in the past several months, Fifth District business activity apparently continued to move along a plateau. Variations in recent published statistics had been typically small and inconclusive, and the Reserve Bank's grass roots contacts suggested that these conditions continued at least through August. Opinions and expectations regarding general business conditions continued to improve, but manufacturers on the survey panel on balance reported a softening in their own businesses. Reports from the textile industry, which employs over one-fourth of all District factory workers, indicated declining orders and shipments, larger inventories, reduced employment, shorter hours, and lower prices. These reports were submitted prior to the Tariff Commission's recent rejection of a cotton price-equalization fee on imports, an action which was likely to have an adverse effect on expectations. Returns from durables producers were less consistent but on balance also showed declines. Only nondurables manufacturers other than textiles continued to report increased orders, shipments, employment, and hours. Tobacco sales, which usually account for about one-third of the value of farm marketings, had to date been well below those of 1961. While prices and volume were improving, tobacco marketings would probably fall 5-10 per cent short of last year's total.

Mr. Wayne found little reason to expect any strong upward thrust in the national economy in the weeks ahead. The fragmentary August evidence suggested that the encouraging pace of improvement in July may not have extended into August. It was true that automobile prospects continued favorable, and that bank loans to business were showing strength. But these developments should be considered in the light of reductions in private construction outlays and heavy construction awards and a probable drop in retail sales. While nonagricultural employment was at an all-time high, the sharp mid-August increase in the unemployment rate was bound to be a source of concern, although much of it could be satisfactorily rationalized.

In establishing policy, Mr. Wayne noted, the Committee continued to be confronted with the dual problem of a less than satisfactory rate of domestic expansion and persisting external imbalance. Over the past several months it had sought to maintain a degree of ease at once conducive to a more rapid rate of advance at home and yet in line with liquidity conditions in foreign money and capital markets. The fact that neither the domestic nor the external problem had disappeared did not mean that the posture of monetary policy had been inappropriate. It seemed to him probable that present in both problems were structural elements not susceptible to solution through purely monetary and credit action and that the Committee had pursued the best available course while efforts were being made to devise more basic remedies. In the present circumstances

vigorous policy measures aimed at either problem could result in serious aggravation of the other. Accordingly, he would favor maintaining about the present posture. The new advance refunding was another argument for doing so. Mr. Stone's views on market prospects for the next several weeks were persuasive and suggested that some bulge in free reserves might be appropriate. He would like, Mr. Wayne said, to see free reserves in the vicinity of $400 million and bill rates in the 2.80 - 2.90 per cent range. He also believed that the discount rate should be left unchanged. It might be wise, however, to drop the word "further" (preceding "monetary expansion") from the opening clause of the directive, since the money supply had actually been declining recently.

Mr. Mills said that, assuming the absence of any event requiring emergency policy action, he would favor experimenting with a monetary and credit policy that implied relative ease rather than relative tightness and focused on the money supply. To outline his views more specifically, he then presented the following statement:

> In the interval before its next meeting, the Open Market Committee would be well advised to aim its objectives at raising the level of free reserves to a range of $450 million or above. A higher level of free reserves would serve the purpose both of facilitating the completion of the Treasury's advance refunding operations and of nurturing an increase in the faltering money supply, which latter is a matter of growing importance. While the increase in the Treasury's balances in Tax and Loan Accounts at its depositary banks has been a factor in keeping down the growth in the money supply as conventionally defined, it may also have had the effect of exerting a generally deflationary economic influence, in that the funds drawn out of private sectors of

the economy by Treasury financing, in not having flowed back into private uses, have deprived the economy of whatever stimulous it would have received if these funds had remained for spending in private hands. Under these circumstances, the employment by commercial banks of additional reserves placed at their disposal by Federal Reserve System policy actions should help to foster an expansion of credit that, in turn, would support the money supply.

Inasmuch as there continues to be a lack of aggressive demand for commercial, industrial, and securities types of commercial bank loans, any marked expansion of credit in that area is unlikely, whereas time and savings deposit accretions should be sufficient to finance further growth of real estate mortgage and consumer instalment loans. Such being the case and as statistical measures indicate ample unused credit availability, a Treasury financing operation offers the most desirable expedient through which the money supply can be stimulated in the near future. It is, therefore, to be hoped that the Treasury will extend Tax and Loan Account privileges to commercial banks participating in its approaching offerings of tax anticipation bills and that adequate reserves will be supplied by Federal Reserve System actions to carry this financing. In my opinion, there is an overriding necessity for the Open Market Committee to focus its attention on actions backstopping the money supply so as to forestall any possibility of an accelerating downward trend in its volume that could lead eventually to liquidating pressure on commercial bank loans and investments and to an undermining of the values on which they are based.

Also, in my opinion, attainment of the policy objectives proposed could better be achieved by a reversion to a "bills only" policy for supplying and withdrawing reserves which would allow a free market to set a pattern of interest rates consistent with both the domestic and foreign financial considerations that have been the subject of the Open Market Committee's discussions for a long while. Moreover, I believe that an interest rate structure developed out of free market movements and unimpeded by artificial interference, in being acutely sensitive to Federal Reserve System policy actions, offers the best means by which any desired changes in policy can be brought to bear most promptly and effectively as they are needed.

In conclusion, Mr. Mills commented that his thinking had a great deal in common with the reasoning expressed by Mr. Koch. He also said

that he did not feel the directive needed changing or that there should be any change in the discount rate.

Mr. Robertson presented the following statement:

I favor a policy of greater monetary ease--introduced as soon as the pending Treasury financing is past--as the best means available to us of promoting lasting progress toward the two objectives of domestic prosperity and a viable balance of payments position. I have not been persuaded of the need for tighter credit policy at home to reverse short-run capital outflows, and indeed I have been somewhat critical of the lack of evidence to support such a policy. On the other hand, it is most important that we all keep trying to explain our persuasions, as clearly and concretely as we know how, in order that the Committee collevtively can make its decisions in the light of all pertinent information.

Accordingly, let me try to set forth, as plainly as I can, where and how I think an easier monetary policy can contribute to the national interest. In the first place, I think there is room for more aggressive loan competition among banks. More stimulative effects would result if businesses could be encouraged as much as possible to choose bank rather than nonbank alternatives for financing assistance, particularly at this time when some signs of increased business demand for short-term credit are appearing. While lenders may speak of funds being available, the fact is they have not been sufficiently available to lower bank lending rates. Rates on consumer loans appear little changed, mortgage rates are only slightly lower, and the prime rate for business loans has stuck at 4-1/2 per cent for two years, following a one-half point drop from its cyclical peak in 1959 and 1960. Protests might be made that interest rates make little difference in the lending field, but I would remind you of the galvanized changes that took place in another area where interest rates were not supposed to have much effect--namely, the savings field--following the changes in bank rates paid on time deposits that were introduced earlier in this year. Interest rates do affect a fraction of decisions; they do condition people's choices among financial alternatives; and I believe our structure of lending rates ought to be on the side of encouraging expansion at this stage.

Proponents of added monetary ease can draw assurance from the relative absence of credit abuses prevalent today. Both business and consumer credit seem to be extended on a fairly judicious basis; we hear little about competition in easing terms, and reported delinquencies and loan losses are low.

Even securities credit, which certainly has been tested more strenuously than other types of credit in recent months, has shown no sign of general weakness. The one area of credit about which some reservations may be justified is real estate credit. But here two points should be kept in mind. First, in the particular geographical and functional areas in which real estate markets show signs of overextension, more factors than credit ease have contributed to the condition, and it is likely to require a good deal more than credit restraint to remedy the situation. Indeed, to judge from the experience of other markets, the real estate adjustment, if and when it comes, is likely to proceed more constructively in an atmosphere of reasonable credit availability rather than the reverse. Second, we must remember that we are operating with <u>general</u> monetary controls, and this compels us to judge their appropriateness in terms of <u>general</u> credit conditions, not those of the specific market most exposed. To change policy, or to refrain from changing it, on the grounds of developments in a particular market is to try to use our general tools as instruments of selective credit control. We must either trust the operations of the private financial system to arrive at sensible distribution of credit (as we did, by and large successfully, in the case of the sharp expansion of consumer credit in the mid-1950's) or retreat to reliance upon some form of selective control, which I know is an administrative anathema to all of us.

There was a time, earlier this year and last, when a policy of less credit availability was advocated in order to reduce the "leakage" of credit ease abroad in terms of bank loans to foreigners and foreign capital issues in this country. Recent months have seen a sharp falling off of such flows, for reasons which I believe we all could agree are largely unrelated to conditions in United States credit markets. Any inhibitions to greater monetary ease because of such flows should now be correspondingly reduced.

But the impact of monetary policy does not end at the loaning officer's desk. The unique aspect of bank credit is that it involves deposit creation as well. The economy needs both bank loans and bank deposits, and it is the responsibility of monetary policy to see that there is enough of both. On this latter score the record is most discouraging. The latest figures show the money supply dropping almost a billion dollars in the last half of August, to a level 1 per cent below the turn of the year despite the intervening advance in business activity. Notwithstanding the fact that the current directive to the Account Manager explicitly calls for "providing moderate reserve expansion in

the banking system," we have in the past three months seen the total of required reserves behind private deposits slide over $200 million below the moderate seasonal-plus-3 per cent-growth pattern posited in the staff memorandum. We must not become complacent about a level of free reserves which is being maintained in good part by unseasonal shrinkages in required reserves. A similar misinterpretation of free reserve statistics threatened us with some serious difficulties in the winter and spring of 1960; I am sure we all want to avoid that happening again.

To be sure, the slackness in the privately owned money supply has been associated with a higher than usual total of Government deposits, but that level of Government deposits has averaged in the neighborhood of $7 billion since May and is likely to continue high for another month; this has been no temporary and insignificant shift of deposits away from private hands.

Where once one could take some comfort from the belief that a good deal of monetary growth was being concealed in the rapid upsurge in time deposits earlier this year, the fact must now be faced that time account growth has slackened to less than its 1961 pace.

I am sure no one in this room wishes to be a slavish advocate of any particular mechanistic formula for monetary expansion, but I think we must be equally wary of falling into the trap of assuming that whatever rate of change in money supply accompanies our policies is prima facie sufficient for the economy. Other forms of privately owned liquid assets are continuing to mount, but the sum total of privately owned liquidity, however, defined, does not appear to be expanding at a pace commensurate with prosperous levels of economic activity. Furthermore, the increased importance of short-term Treasury securities in total financial saving, and the increased importance of net financial saving in total savings flows, means that the funds of consumers and businesses are being funnelled into something less than the most stimulative channels. The prevailing interest rate structure is helping to influence private savings, spending, and investment decisions in this direction. In brief, that rate structure, which our current monetary policy is helping to sustain, is aggravating a significant restraint upon domestic expansion, namely, the present extraordinary penchant of businesses and consumers for financial claims rather than goods.

Could we do something about it? It seems to me we could. If we would provide additional reserves to the banking system (say, maintain $500 million free reserves, to be overprecise

in order to be concrete), banks without doubt would employ the added funds. If they found limits in the amount of loan demand which they could develop and accommodate within the limits of prudence, they could again step up their purchase of investment securities, adding to public liquidity and contributing to lower interest rates and more buoyant capital markets which might attract some hesitant long-term borrowers.

All these effects might not, and indeed need not, lead to more than moderate increases in a fraction of the spending decisions being made in our economy. These, after all, are precisely the dimensions in which monetary policy is supposed to operate at its best. Faith in monetary policy as a useful countercyclical tool has been built upon its timely marginal influence. I see no reason for us to lose that faith. By exercising our powers for greater monetary stimulation now, when real resources are available to produce and when our gold stock is still more than sufficient to protect us from any rumor-spawned speculative raids on the dollar, we can hope to contribute to a prosperous and more rapidly growing economy that will command renewed and more deeply rooted respect for both our economic system and our currency.

With regard to the directive, Mr. Robertson said he could agree with the wording. However, the manner in which the directive was being implemented must mean that his interpretation of the language was different from that of others. Therefore, the directive should be changed, in his opinion, to indicate that the Committee desired greater monetary ease. With this in mind, he would drop the part of the final sentence that called for maintaining a "moderately firm tone in money markets."

Messrs. Young and Coombs joined the meeting at this point.

Mr. Shepardson said that Mr. Wayne had stated his position about as completely as he could state it himself. He felt that the Desk should be prepared to meet seasonal reserve needs, but within the framework of

the present degree of monetary ease and the present tone of the market. In view of the current Treasury refunding, it seemed to him that the Committee would almost automatically want to maintain a position of stability for the next few weeks. In summary, he would favor no change in current policy or in the language of the directive.

Mr. King expressed general agreement with the views stated by Messrs. Wayne and Shepardson. He did not believe that a policy of greater ease would actually solve any current problems. However, he did not attach to the bill rate quite the degree of significance that others seemed to attach to it. Mr. Wayne, as he recalled, had suggested maintaining the bill rate between 2.80 and 2.90 per cent. He (Mr. King) would not be upset if the bill rate slipped a little below the present levels.

Mr. Mitchell said it seemed to him necessary to come back to the basic question of what could be expected of a private enterprise economy. If one were satisfied with the current levels of resource utilization, he should be in favor of continuing the status quo in terms of monetary policy. For others it seemed to him the questions were whether it was known what was wrong and whether it was felt that something could be done about the stiuation. He was not sure that he knew what was wrong. The economy was healthy in many respects. Inventories were in very good shape and, compared with several months ago, the stock market was better adjusted to the prospects of the economy. The country was not in an ideal position as far as the wage-price spiral was concerned, but it was better off in

this respect than it had been for a long time. Thus, it might appear that the economy was now in pretty good shape.

Regardless of such an analysis, however, Mr. Mitchell was not fully prepared to believe that the only way to achieve a better utilization of resources was through changes in Government spending and taxes. In any event, moreover, it would be a matter of six to nine months before any action in those respects could be anticipated.

There was another factor that had been bothering him for some time, Mr. Mitchell said. He felt that the maintenance of the short-term rate was a road block because it was too profitable for investors to remain liquid. If an investor was uncertain about the prospects of the economy, he could afford to stay invested short at the level of current short-term rates. An effort should be made to cure this situation. If the System would release its grip on the short-term rate a little, perhaps debt management would also release its grip somewhat. This might provide enough marginal stimulation and enough incentive to bring about an improved utilization of resources with a minimum of Governmental interference in the private economy. The System, he thought, could do a little more in this regard than it was presently doing. This was the basis on which he would suggest letting the short-term rate drop, although not so far as to create a balance of payments dilemma. If it were not for that dilemma, he would advocate a 2 per cent rate, or perhaps an even lower rate. In the present

circumstances, he would suggest giving the 2-1/2 per cent level a chance to operate.

Mr. Fulton reported that sentiment among businessmen in the Fourth District was not quite as gloomy as it had been, perhaps for no other reason than that businessmen were becoming inured to the shocks, such as the stock market decline, that the economy had experienced. While they expected no sharp improvement, neither did they seem to expect a sharp and abrupt downturn.

In the steel industry, production had been rising gently over the past couple of months, mainly because customers were running out of inventory, but there was no substantial upturn in orders. Thus far the automobile industry was not ordering in quantity; one wondered when the companies would begin to order steel in greater volume for the new-model cars. Seasonally adjusted unemployment had remained substantially unchanged for several weeks; despite lay-offs due to auto model changeovers and plant vacations. For the District as a whole, building activity turned down sharply in July, and August reports for Cleveland and Cincinnati showed a further decline. The region had made the poorest statistical showing in construction activity of any area in the nation. Except for one poor week, department store sales in August were about comparable to the July level, and for the year to date they were about 2 per cent ahead of a year ago. All in all, it might be said that activity in the Fourth District was sluggish.

Turning to District financial developments, Mr. Fulton said that the earning assets of reporting banks--both loans and investments--moved up slightly in August, this having been the first August increase in the past four years. Considerable competition for loans was reported. There were complaints that lenders from outside the District were offering mortgages at around 5-1/4 per cent with maturities up to 30 years, and rates of 5 to 5-1/2 per cent were being offered on instalment loans to encourage borrowing. Considerable competition also was reported for term loans. Thus, it seemed that there was an adequate supply of funds if people could be induced to borrow.

Mr. Fulton expressed the view that monetary policy had been favorable to the borrower, and that credit was rather obviously available. He felt that a continuation of the present policy pattern was in order rather than a policy of trying to saturate the banks with money, with the complications that would ensue. While he did not pretend to know exactly what was wrong with the economy or the specific cure, the policy that had been followed seemed to be favorable to the general situation. He would not change the discount rate at this time, and he would have no objection to continuation of the directive in its present form.

Mr. Bopp reported little evidence of vigor in the Third District economy. It was true that department store sales were improving and residential construction awards had moved up recently; but weekly hours in manufacturing had been dropping since April, the help wanted index had

been dropping since March, and manufacturing employment recently declined somewhat. And, of course, the persistent problem of continuing high and rising unemployment rates in all but a few favored areas was still present.

Loans at District banks had been increasing rapidly, with about half of the increase in business loans. Consumer loans, real estate loans, and loans to sales finance companies and other financial institutions had also increased significantly. The increase in loans, together with declines in investments and deposits, had produced a decrease in bank liquidity. Moreover, bank reserves, particularly at the larger banks, appeared to be under increasing pressure.

So long as unemployment and prices continued at present levels, Mr. Bopp felt that System policy should be directed not only toward providing enough reserves to accommodate impending seasonal needs but toward producing a liberal expansion of money and credit. For the present, however, he would maintain the status quo. He would continue the existing directive and make no change in the discount rate.

Mr. Bryan reported that he could find no developments of real significance in Sixth District economy, which seemed to be following about the same pattern as indicated by the national figures.

There seemed to be some debate, Mr. Bryan noted, as to whether monetary policy could be more stimulative, and as to what the System might have been expected to do that it had not done. Part of the argument centered around the perverse behavior of the conventionally-defined money supply in recent months. The banking figures had done

precisely what one would have expected them to do in a situation in which the Federal Reserve supplied reserves. From November 29, 1961, to June 27, 1962, banks expanded their loans and investments by $10.6 billion, on a seasonally adjusted basis. However, since the public had chosen not to put its funds in demand deposits, the money supply--as conventionally defined--had not behaved in the way that might have been expected. There was always a problem in appraising a situation of that kind. When the gross national product did not behave according to estimates, there was an inclination to blame the economy rather than the estimates. When the money supply did not behave as it was thought that it should behave, there was a tendency to get upset, whereas one ought to question the definition.

Mr. Bryan noted that the volume of total reserves had been kept mounting fairly well. The long-run trend line had been exceeded for a while; and in recent months the figures were fairly close to that line. Borrowings from the Federal Reserve Banks were low, so there was no restraint indicated there.

His judgment, Mr. Bryan said, was that the System ought to supply reserves to meet seasonal needs fully, and to provide a growth factor which, for want of a better figure, he would put at 3 per cent annual rate. This, he thought, could be reconciled with free reserves of $400-$450 million. However, if temporary tightness should develop in the market because of factors such as Mr. Stone had mentioned, he would not be upset if free reserves went above $450 million. This was a time when the tone and feel

of the market was appropriately a part of the guide that the Account Manager should use.

As to the discount rate, Mr. Bryan said he would not advocate any change. As to the directive, he was not convinced that any change in language was necessary at this particular time. He did feel, however, that a reform in the pattern of the directive was worthy of continued consideration.

Mr. Bryan also said that he was not as yet convinced that the economy was now peaking out and going into a decline. However, that could prove to be the case. If so, the Committee at some point might be confronted with a "moment of truth," so to speak, with regard to policy. If it supplied the reserves necessary for growth in the face of a declining economy, there were going to be interest rate reductions from the pressure of savings. Then, if the System tried on account of the international situation to maintain interest rates, it would in effect be pursuing the economy downward and aggravating a deflation. That would be the moment of truth.

Mr. Francis reported that Eighth District business activity continued to fluctuate in July and August around levels established in the second quarter of the year. Employment had increased only slightly since the beginning of the second quarter and the unemployment rate had leveled out at just over 5 per cent. Department store sales in recent months were near the March levels.

Bank debits had shown a slight increase since April. Business loans, after recovering from a first-quarter decline, were unchanged

since June. An element of strength was found in the continuing advance in the industrial use of electric power. Bank deposits were unchanged since June; they had advanced only slightly since the first quarter. The continued increase in time deposits during July and August was offset by a decrease in demand deposits, which had declined in six of the past eight months. Cash receipts from farm marketings in the first half of the year were about 3 per cent above the total for the same period in 1961. Dry weather had damaged pastures quite severely in some areas. Corn, cotton, and soy beans had been damaged somewhat, but not sufficiently to alter the over-all prospects greatly.

Mr. Balderston commented that the Committee continued to face a conflict between domestic and international problems. At the August 21 meeting he had suggested that the effect of greater liquidity on domestic activity was uncertain, whereas the impatience of foreign central banks holding increased amounts of dollars was being made clear increasingly. Thus, he found himself caught between domestic troubles, about which he felt somewhat uncertain, and foreign claims being pressed upon this country, about which he felt certain.

Since the current Treasury refunding implied a continuation of present policy for the next three weeks, Mr. Balderston said, he would like to suggest certain limitations that surrounded monetary policy as a prelude or orientation for the problems that seemed likely to confront the Committee once the refunding was over. On the domestic side he saw

two limitations on achieving national goals through monetary policy. For one thing, of the total flow of credit and equity market instruments the part supplied by commercial banks was now running about one-fourth, whereas in 1959--also the second year after a cyclical upturn--the percentage was only one-tenth. Second, monetary policy seemed unable to improve the profit expectations that were so necessary to greater investment. It was able to do little to induce employers to hire more people at wage rates they considered too high; and this country did not look as inviting as it once did in the eyes of investors. Job opportunities were restricted by wage rates that had been raised unconscionably.

On the international side, meanwhile, it seemed clear that the patience of this country's creditors was nearing an end. This country was being told, not alone through withdrawals of gold, that its creditors wanted no more dollars. Suggestions were coming from abroad in the form of measures that could be contrived to enable the central banks of other countries to hold dollars despite political and other pressures to draw gold from the United States. What monetary policy could do about that problem was not clear to him. The basic cause of the trouble, namely, Government spending and lending abroad in excess of what this country could afford to pay, constituted something that monetary policy could not solve.

In arriving at the System's policy determinations for the fall, Mr. Balderston considered it important to do everything possible on

both of these fronts, but to recognize all the while the severe limitations.

As to the next three weeks, Mr. Balderston said he would not change the policy directive. He called attention, however, to the format of policy directive that had been suggested by Mr. Knipe with the thought of casting the directive in more concrete terms and thereby making it more understandable. Mr. Balderston expressed the hope that the bill rate and the Federal funds rate might remain close to three per cent, but he agreed that seasonal reserve needs should be met fully.

Chairman Martin commented that he found this meeting encouraging. The presentations indicated that everyone was thinking seriously about the problems confronting the Committee and the economy, which was all that could reasonably be asked. He would like to associate himself with those who disclaimed their ability to discern precisely the right thing to do at the present time.

It seemed obvious to him, the Chairman continued, that the majority position at this meeting favored maintenance of the status quo for the next three weeks.

Continuing with a personal comment on the broad picture, Chairman Martin said he would not give up the ship too readily because of the slowness of economic advance. He thought it would be necessary to wait and see what the fourth quarter held.

In another observation, the Chairman noted that statistics are important. However, he was distrustful of them when his common sense told him something different from what the statistics suggested. At the present time there was, in his opinion, no inadequacy of funds and no lack of liquidity. His inquiries had not produced evidence to such effect, or situations where parties would have borrowed, or borrowed more, if money was available at 1/2 per cent less. He was convinced that there was a point at which further monetary ease would do harm instead of good. He did not know exactly when that point was reached, nor would he want to say that it had been reached. Sometimes, however, shadows can be seen in advance.

The Chairman went on to make the comment that Messrs. Robertson and Mitchell had performed a service at this and recent meetings by presenting so thoroughly the reasoning underlying their positions. Similarly, Mr. Mills had rendered a service earlier this year by explaining a position that was contrary to the view of the majority at the time. There should not be disagreement just for disagreement's sake. However, if the Committee was going to succeed in its task of formulating appropriate monetary policy, all ideas should be put on the table, after which the Committee should try to pull together. Fortunately, while there had been questions from time to time within the group, there had also been a close enough approach to unanimity of opinion to permit a feeling that the Committee was able to make progress. Obviously, if there was an

inclination to pursue any particular line of thought as a hobby, that could be disastrous in the area of monetary policy.

Chairman Martin mentioned that he had observed over a period of years a tendency on the part of persons outside the System to suggest that monetary policy should bear an undue share of the burden in achieving national objectives. The existence of this general tendency was something to which the Committee must reconcile itself.

The Chairman said it was his observation that, while the economy could suffer severely from undue stringency of credit, over the longer run it was not likely to suffer so severely from a monetary policy that was too restrictive as from one that was too easy. Mr. Mitchell had made his point well: in a period of uncertainty the holding up of the short-term interest rate might deter some people from taking chances that they otherwise would take. At the same time, although a good many years had passed since the end of World War II, the economy of this country was still suffering from the inflationary overhang.

It concerned him, the Chairman said, that at some point there might be a world-wide slowdown. Further, if there should be a domestic slowdown in the fourth quarter--something he had not yet conceded in his own mind--that would be the second occasion in recent times where the economy of European countries would appear stronger than that of the United States. As to the situation abroad, while Europeans were talking about six or nine months more of expansion, they were beginning to see strains in their own economies.

One must recognize, Chairman Martin continued, that there were some fundamental factors in the picture of a structural nature--part of the heritage of a long period of inflation. While he was in favor of doing everything within reason through monetary and credit policy to assist the necessary adjustments, he was not in favor of creating money simply to accommodate foolish expenditures, speculation, or lower credit standards, and thus postpone adjustments of a fundamental nature that must be made. He was not saying that this was necessarily the time at which such results would occur, and he might be wrong in his judgment. This summer, however, he felt that monetary policy had behaved correctly, in terms of both the domestic economy and the international situation. He did not believe that monetary policy had been a damper on the domestic economy in any sense of the word. It might become a damper, of course, if the economy got into a period of real decline. In that event, steps should be taken, perhaps, to ease money further, but during this past summer stability was the primary objective; the confidence factor was of paramount importance. In his opinion, monetary policy would have been put in the role of tending toward irresponsibility if the Federal Reserve had pursued an inordinately easy policy during the summer in the aftermath of the stock market adjustment. At present, with the annual Fund and Bank meetings about to occur and the balance of payments situation precarious, it would be irresponsible to assume that the Federal Reserve

could ignore the exigencies of world finance, particularly the confidence factor.

In further comments, the Chairman spoke favorably of the complementary nature of debt management and monetary policy at the present time. During the past two years, the blending of these operations had been particularly effective, as effective as he could remember in his experience. This had worked toward a stability in monetary operations, and he believed stability was needed. In his view the most effective contribution monetary policy could make was not to go off half-cocked in either direction at the present time but rather to lend stability to the economy. A time might be approaching when the business picture could be appraised more clearly; that might be possible by the date of the next Committee meeting.

Chairman Martin forecast a fast decline in interest rates, regardless of anything the Federal Reserve might do, if business should decline appreciably. And he would not want to abet such a decline in interest rates in advance of a recession. There were a lot of problems, he repeated, that were a part of the heritage of World War II, and he did not pretend to know the answers. Neither, as he had said many times on previous occasions, did he pretend to understand the workings of the money supply. Of one thing, however, he felt fairly certain. When people were not complaining of inability to obtain money and lenders were trying to seek out borrowers, there

was something in the picture of a more fundamental character than lack of growth of the money supply.

Reverting to the consensus of this meeting, the Chairman repeated that it was his understanding that the majority position was clearly in favor of maintenance of the status quo.

In discussion of this point, Mr. Mills asked the Account Manager how he would interpret "status quo." His feeling, Mr. Mills said, was that one would have to think in terms of at least the two most recent meetings of the Committee, which would imply a level of free reserves of around $350-$400 million. His impression--and he thought perhaps the impression of a majority of the Committee--was that it would be appropriate to raise the level of free reserves to some degree to obtain the results that were being sought. This was consistent with Mr. Stone's suggestion that in the immediate future there might be a hidden tightness in the reserve position that should be lubricated by allowing free reserves to increase.

Chairman Martin said he had been going to comment on the difficulty of using the free reserve figure as a guide in the present circumstances. He would go along with the thought of Mr. Deming and others that reference should be made primarily to the color, tone, and feel of the market in talking about maintenance of the status quo at the present time, rather than to a specific level of free reserves.

Mr. Stone said that this coincided with his interpretation.

Mr. Mills then commented that if he were the Account Manager he would feel rather at loose ends in trying to determine the appropriate nature of day-to-day operations for the System Account.

Mr. Stone replied that he had interpreted the intent of the Committee's recent instructions as placing emphasis on maintaining the color, tone, and feel of the market. That was what had been sought by the Desk, and he would like to continue on that basis.

In this connection, the Chairman commented that he did not know what words might best be used in the policy directives to clarify the Committee's instructions to the Account Manager. In a memorandum distributed yesterday, Mr. Knipe had made a suggestion for a somewhat different type of directive, and this suggestion deserved thought and study. This was a question that had come up repeatedly. Everyone should continue to give attention to the possibility of improving the nature and elements of the directive. However, he doubted whether the Committee was going to be able to contrive any method of instruction that would offset the need for exercise of discretion on the part of the Account Manager. This was exemplified by problems that arose at the Desk one day recently when he and Mr. Deming happened to be present. He questioned whether it was possible to deal with such things satisfactorily in the policy directive.

The Chairman then inquired as to the members of the Committee who would like to be recorded as dissenting from a policy of maintaining

the status quo, within the context of the preceding discussion, and Messrs. Mitchell and Robertson said they would like to be recorded as dissenting.

Mr. Mills said he would like to make a comment in this regard. If the Account Manager's interpretation of the color, tone, and feel of the market should develop to be markedly different from his own interpretation, and if he (Mr. Mills) felt that adequate reserves had not been supplied, he would reserve the right to be frankly critical at the next Committee meeting.

Chairman Martin noted that this right was reserved to each Committee member at each meeting.

Mr. Hayes commented that in listening to Mr. Mills' earlier statement he had gotten the impression that the policy favored by Mr. Mills would be somewhat easier than that favored by a majority of the Committee. Therefore, he would expect Mr. Mills to be dissatisfied if operations for the Account reflected the policy that appeared to be favored by the majority.

Chairman Martin said this was also his understanding. Accordingly, he wondered whether Mr. Mills would not be well advised to vote against the majority position.

Mr. Mills then suggested a poll of the Committee to ascertain whether there was a clear majority in favor of maintenance of the status quo.

Accordingly, such a poll was taken, with the result that nine members of the Committee expressed themselves as favoring maintenance of the status quo while Messrs. Mills, Mitchell, and Robertson dissented.

Mr. Bryan, who had aligned himself with the majority in the poll, explained that his suggestion for a free reserve target ($400-$450 million) did not seem to be too far from the view of the majority, particularly when the status quo was being thought of primarily in terms of maintaining the color, tone, and feel of the market.

In further discussion, Mr. Stone repeated that he had been interpreting the Committee's position as placing primary emphasis on the tone, color, and feel of the market. The Desk had looked at the Federal funds rate and the bill rate, among others. In recent weeks, this had resulted in the prevailing range of free reserves. In future weeks, it might involve a higher level of free reserves.

Mr. Hayes expressed agreement with Mr. Stone. It seemed important to distinguish this approach from Mr. Mills' view, for the latter had spoken of a higher level of free reserves as an objective. Under Mr. Stone's approach, a higher level of free reserves might develop, but only as the necessary concomitant of an attempt to maintain the prevailing color, tone, and feel of the market.

Mr. Mills commented that if there was reluctance to supply reserves and they were only supplied under the pressure of other guides, it was his contention that the Desk would be exerting a distinctly restrictive policy pressure.

Mr. Hayes replied that he did not think the Account Manager had indicated any particular reluctance to supply reserves. He had indicated complete willingness to attempt to achieve stability. If it developed that this attempt involved higher levels of free reserves, Mr. Hayes assumed the Manager would not be reluctant to supply reserves.

Chairman Martin then inquired whether there were any further 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.

> Votes for this action: Messrs. Martin, Hayes, Balderston, Bryan, Deming, Ellis, Fulton, King, and Shepardson. Votes against this action: Messrs. Mills, Mitchell, and Robertson.

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 August 21 through September 5, 1962, and a supplementary report for the period September 6 through September 10, 1962. Copies of these reports have been placed in the files of the Committee.

In the course of comments supplementing his written reports, Mr. Coombs noted that an easing had occurred in the exchange rates of certain European currencies, and the Account Management had been trying to take advantage of the situation. Purchases of Netherlands guilders had reached a total of about $35 million equivalent, against System drawings of guilders to the extent of $50 million under the swap arrangement with the Netherlands Bank. Drawings of $35 million having been repaid through use of the purchased guilders, that amount of the swap facility had reverted to a standby basis. The Treasury had outstanding $20 million, so the total short position in guilders was now about $35 million.

Also, Swiss francs to the equivalent of about $10 million had been picked up in the past week or so, and would be used toward the repayment of drawings under the swap arrangement with the Bank for International Settlements. Further, it appeared that it might be possible to make some start shortly toward repaying drawings under

the swap arrangement with the National Bank of Belgium.

Mr. Coombs said that the System's efforts to pay off its drawings under the swap arrangements as fast as possible had made a good impression on bankers abroad. These efforts had quieted apprehensions that the swap facilities might be abused; that short-term credits could drag on indefinitely. Therefore, it was fortunate that there had been a reversal of the flows of funds so quickly after the drawings were made, and that the System had been able to move so fast to make repayments.

Purchases of about $15 million of German marks had replenished the System's mark holdings almost to the level at which they stood before the intervention operations of June and July. The Treasury also had replenished its holdings of marks, and combined Treasury and Federal Reserve holdings now totaled around $60 million equivalent.

Mr. Coombs noted that the Canadians had received a heavy flow of money during the past few months; their reserves had been built up by more than half a billion dollars since the Canadian stabilization program was inaugurated in the latter part of June. However, the Bank of Canada had expressed a desire to have the swap arrangement with the Federal Reserve, which would expire September 26, 1962, renewed for another three months on the same terms as the existing arrangement. Question had been raised whether a standby swap facility might not serve as well, but the Bank of Canada would prefer actually to have

the U. S. dollars in its reserves. Hence, it would like to renew the present arrangement if that was agreeable to the Federal Reserve. The Bank of Canada had been kept posted on the efforts of the Federal Reserve to pay off its outstanding drawings under swap arrangements in advance of maturity, but thus far there had been no indication that, if the Canadian swap were renewed, the Bank would move to unwind it before the end of the renewal period. It would be expected, of course, that the swap would be unwound at the end of the additional three months.

In the course of further discussion of the Canadian situation, it was brought out that the rationale of the original swap was to allow the Canadians time to introduce constructive measures to improve the country's basic international payments position. Although the Canadian position had already improved markedly, a three-month renewal of the swap facility could be justified on the basis that there had not yet been time for adoption of a longer-run program of constructive measures.

> Accordingly, a three-month renewal of the Federal Reserve-Bank of Canada $250 million swap arrangement on the same terms and conditions as the original agreement was authorized.

Turning to the swap arrangement with the Netherlands Bank, Mr. Coombs noted that it would mature on September 14, 1962. In his opinion a three-month renewal would be agreeable to the Netherlands Bank and of advantage to the Federal Reserve. However, he believed

the Netherlands Bank might request a shift in the interest rate basis from an arbitrary 2 per cent rate to one based on the U. S. Treasury bill rate.

> Thereupon, upon recommendation of Mr. Coombs, the Committee authorized a renewal for three months of the $50 million swap arrangement with the Netherlands Bank.

In the case of the $50 million swap with the National Bank of Belgium, Mr. Coombs noted that this arrangement would not mature until December 20, 1962. The possibility of a standby facility had been suggested by him to the National Bank of Belgium, but the National Bank had preferred to have the original swap agreement executed on an outright basis.

Mr. Coombs next referred to the problem he had mentioned at the August 21 Committee meeting relative to acquiring guilders through direct transactions with the Netherlands Bank. He had recommended, and the Open Market Committee had concurred, that guilders should continue to be acquired at the market rate rather than to accept a proposal from the Netherlands Bank that System purchases be arranged at a special arbitrary rate at such times as the System wished to purchase guilders in substantial quantity. The problem was that on some days guilders were available in the market in only limited amounts. In the circumstances, he had endeavored to think of some compromise solution that would enable the purchase of larger quantities of guilders

while continuing the market rate principle. It had occurred to him that the System might pay a stipulated commission or fee to the Netherlands Bank for the convenience of obtaining sizable lots of guilders through direct transactions with the Netherlands Bank. He had mentioned this possibility to the Netherlands Bank, and yesterday he had received word that the Bank would be agreeable in principle to such an arrangement. The Bank had suggested that the commission might be fixed at the rate of 1/8 per cent. Such a rate, Mr. Coombs pointed out, would result in roughly an equal sharing between the Federal Reserve and the Netherlands Bank of the profits accruing from System drawings of guilders when the dollar was weak and purchases of guilders after the dollar had strengthened. The Treasury also was involved because it had $20 million of guilder drawings outstanding that it was anxious to liquidate quickly. Accordingly, he had inquired whether such an arrangement would be acceptable to the Treasury, and had found that the Treasury would be agreeable. If the Open Market Committee concurred in such an arrangement, it should be possible to clean up the guilder operation completely in the course of the next week through purchases of $15 million of guilders for System account and $20 million for Treasury account. If the arrangement was not favored, he feared that the guilder operation would drag on, with relatively meager possibilities of acquiring guilders through the market.

In reply to questions, Mr. Coombs confirmed that the Federal Reserve Bank of New York made no charge when it executed foreign exchange transactions on behalf of foreign central banks. The commission would be unusual in interbank relationships, but the use of an arbitrary rate that deviated from the market rate concerned him even more. He felt that the System would be on better ground if it continued to adhere to the concept of executing foreign exchange transactions only at the market rate, but paid a fee to the Netherlands Bank for the convenience to the Federal Reserve of the execution of wholesale transactions direct with the Netherlands Bank.

Mr. Coombs recalled that the current swap arrangement was initiated with a view to mopping up dollar holdings of the Netherlands Bank in excess of the traditional $200 million limit of that Bank. The Netherlands had subsequently experienced an outflow of funds. At present its total holdings of dollars were down to around $135 million, and another prospective out-payment appeared likely to reduce the holdings close to the $100 million level. Thus, repayment of the System's drawings would build up the dollar holdings of the Netherlands Bank only to a point well below the traditional dollar conversion point.

In reply to additional questions, Mr. Coombs reiterated that the effect of the payment of the proposed commission would be to reduce a windfall profit to the Federal Reserve from its guilder operations. While no parallel question had arisen under swap arrangements with other foreign

central banks, conceivably a question of the same nature might arise elsewhere; the System was just getting into this field. A similar problem, incidentally, had arisen in connection with the repayment of drawings from the International Monetary Fund.

Mr. Coombs further pointed out that the question whether commissions or fees should be paid on other occasions remained at the initiative of the Federal Reserve. In markets the size of the Swiss franc, German mark, or pound sterling markets, there should not be too much difficulty in buying in sufficient quantity at market rates. Hence the question of the size and depth of the various currency markets was involved. He had not been able to think of any absolutely satisfactory solution to the guilder problem, but he had a feeling that the commission plan was the least disadvantageous.

In reply to a question regarding the possibility of waiting until the terminal date of the drawings, Mr. Coombs commented that this would focus the present point of difficulty more sharply. He would prefer to pay off the drawings in advance.

In reply to another question, Mr. Coombs repeated that he saw a substantial advantage in liquidating the swap with the Netherlands Bank as fast as possible in order to demonstrate that the System's operations were designed to deal with reversible flows of funds and that the operations were effective. One never knew when the tide might move the other way, and he would like to have this credit facility completely restored

if possible. The System had to feel its way on this sort of thing. He did not think that the arrangement he proposed would necessarily create a precedent, even in the case of guilders.

Mr. Hayes agreed, noting that the System could always say, even to the Dutch, that it would not be able to operate the same way again. In view of factors such as the differences in the size of the various foreign exchange markets, the System could distinguish among its arrangements more or less on an ad hoc basis.

After further discussion, Chairman Martin commented that the Federal Reserve was engaged in experimental operations. The Committee might want later to establish some principles that would apply to swap arrangements generally. However, if it seemed desirable for the Federal Reserve to liquidate the current guilder drawings and the arrangement proposed by Mr. Coombs seemed to provide the best available mechanism, agreement on a small fee probably was not too much of a price to pay.

Mr. Mitchell commented that in his view the payment of the fee was not too important in itself. The important thing was the principle of parallel treatment. So far as he could see, the payment of a fee had no basis from the standpoint of principles that the System ought to be following.

Mr. Deming inquired whether there might not be more justification for paying a premium if the swap arrangement was being unwound at the last minute then if this were done in advance. Mr. Coombs replied that the

United States would be saving interest. Also, by waiting it might forego the opportunity to make a sizable profit. Mr. Deming then commented that he was not too concerned about the making of a profit or the sharing thereof. It was the principle of paying a fee that was of more concern to him.

Mr. Furth noted that if the System endeavored to buy 15 million dollars of guilders through the market, the market price probably would go up by an amount at least equal to the 1/8 per cent commission. It was quite customary, in the case of Fund drawings, to pay a rate close to the market, taking into consideration the effect of a market transaction on the rate. Therefore, he was not particularly apprehensive about the establishment of a precedent. On a market broader than the guilder market, this simply would not happen. Further, if it became known that a swap operation always was to be reversed on the last day, it would be relatively simple for a central bank to have the market on that day less favorable to the System than the rate involved in the payment of a small commission.

Question was raised of Mr. Coombs whether payment of a commission was actually more desirable than departing from the market rate. If some kind of agreement was in effect whereby the market rate was made subject to a certain adjustment, would this not be better than paying a commission?

Mr. Coombs replied that a rather nebulous area was involved when one tried to ascertain the effect of a large transaction on the market rate. The effect of such a transaction on the market rate might be more or less than 1/8 per cent. As he had indicated previously, the payment

of a commission of 1/8 per cent would come close to splitting between the Netherlands Bank and the Federal Reserve the benefit of this particular operation. This seemed to him better than getting into the question of what would happen to the market rate if an attempt was made to execute a large transaction in the market.

Chairman Martin then suggested that the Open Market Committee approve the plan proposed in this instance by Mr. Coombs, with the understanding that this was clearly not to be regarded as establishing a precedent.

Thereupon, the plan proposed by Mr. Coombs was approved on the basis stated by the Chairman.

Mr. Coombs then commented that over the next few months, a period of the year when there was usually some pressure on the pound sterling, there might be opportunities to pick up sterling at rates of par or below. He thought it might be well, as and when such opportunities arose, to acquire sterling up to a total of not more than $25 million equivalent. Such holdings might be useful in pilot operations after the turn of the year, when the seasonal flow of funds to London might be expected to begin.

Without objection, purchases of sterling along the lines recommended by Mr. Coombs were authorized.

Mr. Coombs also noted that last week in London he had mentioned to British officials that the Federal Reserve System might be prepared to

consider an increase in the present swap facility to $250 million. The reaction, however, was that this might not be the most appropriate time. It was thought that an enlargement of the swap facility might tend to disturb the quiet in exchange markets by suggesting that there might be some apprehension in official quarters about another wave of speculation. If necessary, the British would be prepared to consider an enlargement of the swap facility, but they appeared to feel that about as much was being gained psychologically from the $50 million swap facility as could be gained from a larger one.

After further comments by Mr. Coombs on matters relating to the area of System foreign currency operations, Chairman Martin requested Mr. Coombs to outline a proposal that he had made for the publication of a report on System and Treasury foreign exchange operations.

In reply, Mr. Coombs recalled that at recent hearings before the Congressional Joint Economic Committee, at which President Hayes testified, Congressman Reuss of Wisconsin had pressed again for a report on System foreign currency operations. Thereafter, Mr. Coombs said, he dictated a summary of Treasury and Federal Reserve operations in this field. On his recent trip to Europe, he showed the draft to each of the central banks with which the Federal Reserve had had any sizable operations, and no objection was indicated to the publication of such a paper. When it came to the most appropriate method of publication and the matter of timing, Mr. Coombs was not sure. However, Under Secretary of the

Treasury Roosa had pointed out that a meeting of Working Party 3 of the Economic Policy Committee of the Organization for Economic Cooperation and Development was to be held in Washington at the end of this week. Mr. Roosa suggested that it might be helpful if copies of the paper could be shown to the members of the Working Party. Mr. Roosa also thought that it might be of some use if the paper could be published during the period of the Fund and Bank meetings, to be held next week.

Chairman Martin suggested that the Open Market Committee authorize the publication of the paper and leave the details to be worked out by Mr. Young, with the thought that if it was agreeable to the people involved the paper would be issued as promptly as possible. If it could be issued during the Fund and Bank meetings, those attending the meetings would have available to them something authoritative on what had actually been done in this field.

In reply to a question, Mr. Young said he would have in mind that the paper would be sent to the Congressional Committee and released to the public simultaneously.

Mr. Mills inquired whether this was purely a factual report or a report aimed at explaining the purposes and objectives of System operations and whether they had been realized. In reply, Mr. Coombs said that where it appeared that the operations had been useful in reversing a flow of funds, that would be pointed out. He also mentioned that the larger part of the document was devoted to a discussion of Treasury operations.

The issuance of the paper described by Mr. Coombs was then authorized.

Upon motion duly made and seconded, and by unanimous vote, the open market transactions in foreign currencies during the period August 21 through September 10, 1962, were approved, ratified, and confirmed.

At its meeting on August 21, 1962, the Open Market Committee gave consideration to a letter from Congressman Patman, Chairman of the Joint Economic Committee, to Chairman Martin dated August 14, 1962, with which Congressman Patman transmitted in galley form an unpublished Joint Committee Print consisting of a digest based on the minutes of the Federal Open Market Committee for 1960. The Committee Print was entitled, "How Policies of the Federal Reserve System are Determined." Congressman Patman cited in his letter a resolution adopted by majority vote of the Joint Economic Committee that the Committee Print "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."

In reflection of the position taken by the Open Market Committee following consideration of this matter at the August 21 meeting, there was sent to Chairman Patman on that date a letter over the signature of Chairman Martin indicating, for reasons stated, that the Open Market Committee had concluded it would be desirable to carry over until its next meeting, to be held on September 11, the question raised concerning general publication of the Joint Committee Print. The interim reply from Chairman Martin

also stated that Congressman Patman would be advised of the Open Market Committee's views promptly following the September 11 meeting. In addition to citing the need for more time in order to allow careful study by the members of the Open Market Committee of the question whether it would be in the public interest to publish the Joint Committee Print, Chairman Martin's interim reply referred to an indication in the galley proof of the document that the Joint Committee might plan to include a final chapter that had not been forwarded with the galley proof. Chairman Martin's letter stated that it would be helpful to the members of the Open Market Committee to have an opportunity to review the galley proof of the final chapter if the Joint Committee intended to include such a chapter.

No reply had been received from Congressman Patman to Chairman Martin's letter of August 21. However, there had been distributed to the members of the Open Market Committee for consideration prior to discussion at this meeting a draft of a further reply that might be made to Congressman Patman. The proposed reply would take the position that publication of the proposed Joint Committee Print would not be in the public interest. The view would be expressed that to publicize without a substantial time lapse the minutes of the internal discussions preceding the actions of the Open Market Committee would do public mischief rather than public good. Therefore, the Committee would repeat the request made in Chairman Martin's letter of July 21, 1961, transmitting the minutes for 1960 to the Joint Committee, that their contents be held in confidence.

In the initial phases of the discussion at this meeting, several members of the Committee indicated that they regarded the draft of proposed reply as generally satisfactory and said that their comments, which already had been sent or could be sent to the Committee Secretary for consideration, were of an editorial nature.

Mr. Robertson, on the other hand, indicated that he would not favor sending the proposed letter in its present form because in his view it would foreclose the Open Market Committee from publishing minutes of the Committee in full. He noted that the Committee had considered from time to time the possibility of publication of its minutes for some past period, but no decision had as yet resulted from those discussions. One question involved had always been the lapse of time that would be appropriate. In his view there was every reason for publishing the minutes, after what might be concluded to be a suitable lapse of time, so that they would be available to students of the monetary system. He felt that the reply to Congressman Patman should take the position that the publication of a document such as the Joint Committee Print before the complete minutes were made available to the public would not be in the public interest, but the form of the proposed letter gave him concern.

The reactions to Mr. Robertson's interpretation of the draft of proposed reply varied. One view expressed was that the language of the draft, when read carefully, did not preclude the Open Market Committee, if it so desired, from reaching a decision to publish the minutes of the

Committee after the lapse of a suitable period of time. According to another view, presented by a member of the Committee who did not favor publication of the Committee's minutes, the sending of a letter in the form of the draft would, as Mr. Robertson suggested, raise a substantial question from the standpoint of publication of the minutes.

In this connection, Chairman Martin commented that he did not agree with the view that the minutes of the Open Market Committee should not be published even after a suitable lapse of time. In his opinion, it would be desirable for the minutes to be published after some lapse of time on the theory that this was the best way to reveal to the public the nature of the processes followed in the formulation of monetary policy. While individuals could write in terms of their own impressions, the Committee's minutes were not colored to fit the views of any particular author. However, quite apart from any decision that might be reached later regarding the publication of the Committee's minutes, it was his feeling that the points made in the draft of letter to Congressman Patman were appropriate.

Mr. Ellis said he would like to correct what may have been an erroneous impression created by his remarks at the Committee meeting on April 17, 1962. He had not meant to argue that the Committee should not ever publish its minutes. His argument was intended to go to the point that there should be a suitable time lapse in order to permit the Committee to have the full benefit of private deliberations.

The draft of reply, he noted, pointed out the value of private deliberations to other Governmental bodies in the process of decision-making, and the Open Market Committee should not do anything that would tend to inhibit full and free discussion. As he read the proposed letter, however, it would not preclude the Open Market Committee from publishing its minutes after a suitable time lapse if it so desired.

There followed further discussion based on the differing opinions that had been expressed as to the manner in which the proposed letter might be interpreted. In the course of this discussion, Mr. Mitchell made the comment that the letter should be studied from the standpoint of being sure that it did not prevent the Open Market Committee from taking steps to alter the characteristics of the record of open market policy actions published each year in the Board's Annual Report. In his opinion, the published policy record was in need of improvement. While he had no specific suggestions at this time as to how an improvement might be accomplished, nothing should be said in the proposed letter that would inhibit the Committee from making as full a disclosure of its policy actions as it might determine to be desirable.

There followed certain relatively minor suggestions for changes affecting the tone of the proposed reply. However, since the more basic issue raised by the comments of Mr. Robertson had not been resolved, the meeting recessed and reconvened at 2:10 p.m. with the same attendance as at the conclusion of the morning session except that Messrs. Noyes, Koch, and Yager were not present.

At the beginning of the afternoon session, Mr. Wayne indicated that he would be inclined to favor the letter as drafted, with certain minor changes. However, in order to put before the Committee for consideration an approach that might meet the point raised by Mr. Robertson, he outlined possible changes that would result in a considerably shortened version of the letter.

In the course of a discussion based on the revisions Mr. Wayne had outlined, Mr. Deming suggested that in any further consideration of the possibility of publishing the minutes of the Committee, thought should be given to the material that had been included in the minutes over the past year or so with regard to System foreign currency operations. This aspect was not of concern in connection with the minutes of 1960 or prior years. However, if it should be the decision of the Committee to embark on a procedure of publishing its minutes after a period of time had elapsed, there would ultimately be the question of releasing minutes containing references to foreign central banks and Governments in connection with discussions of foreign exchange operations.

Other members of the Committee agreed that this was a point that should be borne in mind. In this connection, there was a suggestion that exploration of the practices followed by the Department of State might be helpful.

There followed suggestions for the deletion from the draft of letter to Congressman Patman of certain sentences or phrases not

affecting the substance, and there appeared to be general agreement that these sentences or phrases could appropriately be eliminated.

Mr. Bryan indicated that he favored the general approach taken in the draft of letter, which he thought would not preclude the Committee from reaching a subsequent decision, if it saw fit, to publish its minutes for a prior period. He proposed that the Committee approve the draft as the basis of reply to Congressman Patman, subject to such editorial changes as Chairman Martin might consider advisable in the light of today's discussion.

Subsequently, Mr. Ellis offered a proposal to the effect that the Open Market Committee approve the sending of a letter to Congressman Patman, as Chairman of the Joint Economic Committee, stating formally its opposition to the publication of the Joint Committee Print based on the Open Market Committee's minutes for 1960. Such action would make known to Chairman Martin the fundamental position of the Open Market Committee. Then, with the benefit of the discussion that had taken place at this meeting, the Chairman could edit the draft of reply in such manner as he thought appropriate. As Mr. Ellis understood it, the majority view within the Open Market Committee was that the Joint Committee document, based on access to the 1960 minutes, should not be published, that such publication would be against the public interest, and that the Committee therefore wished to request observance of the position it had taken in forwarding the 1960 minutes to the Joint

Committee. The further question had to do with the manner in which this position should be presented in the letter to Congressman Patman. He would propose to leave that question to the discretion of Chairman Martin against the background of the various views and comments that had been expressed at this meeting.

Mr. Robertson indicated that he would be willing to accept a proposal for action by the Open Market Committee along the lines stated by Mr. Ellis.

As the discussion proceeded, however, several members of the Committee expressed agreement with the view that the draft of proposed letter before the Committee constituted, subject to editorial changes, a suitable form of reply. This tended in the direction of action by the Committee along the lines suggested by Mr. Bryan. At the conclusion of this phase of the discussion, Mr. Ellis indicated that he would be prepared to support such a proposal.

Accordingly, it was moved by Mr. Bryan and seconded by Mr. Shepardson that the Open Market Committee approve the draft of proposed reply to Congressman Patman that had been distributed prior to this meeting as the basis of the reply to be made, subject to such editorial changes as Chairman Martin might wish to make in the light of the discussion at today's meeting.

A vote was taken on this motion and all of the members of the Committee voted "aye" except that Mr. Robertson voted "no" and Mr. Mills abstained.

In explanation of his abstention, Mr. Mills said he was concerned that the sending of a letter along the lines that had been agreed upon would cause irritation in the Congress, particularly insofar as it made comparisons between the Open Market Committee and the Executive Branch of the Government, the courts, and committees of Congress. He did not feel that these comparisons were germane. In his view the record of the past three weeks provided an answer to the problem: there was a flurry of discussion when the proposed Joint Committee Print was leaked to the press, but the discussion appeared to have died away subsequently. If the Open Market Committee had agreed to the publication of the Joint Committee Print, expressing regret that such action was being taken and that Congressman Patman had not observed the Committee's request that the 1960 minutes be held confidential, Mr. Mills felt that the Open Market Committee would have been in a better position. If the publication of the Committee Print had produced serious challenges to the Committee's 1960 actions, which he doubted, the Committee would have been in a position to answer those challenges on its own ground and against the record of the minutes.

Secretary's Note: There follows the text of the letter that was sent to Congressman Patman over Chairman Martin's signature under date of September 11, 1962, pursuant to the action taken by the Federal Open Market Committee at today's meeting:

"This is in further response to your letter of August 14, 1962, in which you informed me that the Joint Economic Committee is considering publication of a 'condensed report' evolved from the 1960 minutes of the Federal Open Market Committee. Your letter asks for my position regarding the publication of this document. After carefully considering your letter and the galley-proof version of the report that you sent with your letter, the Federal Open Market Committee today concluded that publication of the proposed report would not be in the public interest, a conclusion with which I agree, and with which I hope your Committee will agree when it reaches its final decision as to whether it will publish this document.

"In weighing the considerations of public policy involved in your Committee's decision, it should be borne in mind that a complete record of all policy actions taken by the Federal Open Market Committee is maintained by the Board of Governors and is set out in full each year in the Board's Annual Report to Congress, as required by the Federal Reserve Act. Included in the report thus made public are: (1) a record, by name, of all votes cast by each member of the Committee in connection with the determination of open market policies; (2) summaries of the economic and financial developments and conditions taken into account in arriving at policy actions; (3) statements of the reasons underlying the actions of the Committee; and (4) statements of the reasons underlying dissents, when there are dissents.

"The statute does not, of course, require publication of the minutes of meetings of the Federal Open Market Committee; indeed, it does not prescribe the form of such minutes as may be kept by the Committee. It has been the practice of the Committee, nevertheless, to maintain full, detailed, often nearly verbatim minutes of its discussions and debates prior to final determinations of policy actions. In distinction from policy actions, for which the complete record has been published as stated, the discussions covered in the minutes have never been made public by the Open Market Committee. In that respect, the Committee has followed a principle long established and universally accepted in the public service--by the Judicial and the Executive branches of the Government, and by the Committees of Congress as well, including your Committee, in respect to their own operations.

"Neither the United States Supreme Court nor any other court, Federal or State, makes public any record of discussions in chambers preceding the announcement of a decision,

although the courts do announce the underlying reasons therefor and the statements of dissents, if any, as does the Open Market Committee. The same privacy of pre-decision discussions extends to the jury room, for reasons that the late Mr. Justice Benjamin Cardozo of the United States Supreme Court put this way: 'Freedom of debate might be stifled and independence of thought checked if jurors were made to feel that their arguments and ballots were to be freely published to the world.'

"The Executive Branch of the Government likewise distinguishes in respect to publication between the conversations taking place at a meeting and the decisions reached at it and--in contrast to what the Open Market Committee has done in this instance--has declined many times, from the days of President Washington down to the present, to make the records of pre-decision discussions at meetings in the White House or various departments or agencies available even to the Congress. As it was explained on one occasion by President Eisenhower, 'It is essential to effective administration that . . . the broadest range of individual opinions and advice be available in the formulation of decisions and policy . . . . The disclosure of conversations, communications or documents embodying or concerning such opinions and advice can accordingly tend to impair or inhibit essential reporting and decision-making processes . . . .'

"The Congress, itself, in the Legislative Reorganization Act, recognized the need for privacy in working sessions of Congressional Committees, by excepting 'executive sessions for marking up bills or for voting' from the general requirement that Committee hearings be open to the public. Indeed, the same Act provides that any committee meeting may be closed to the public upon a majority vote of the members of the committee, as in fact they sometimes are. As a matter of practice, minutes of executive sessions of Congressional Committees are not made available to the public.

"Thus, throughout the public service, the principle has been widely recognized that, in the absence of anything approaching criminal conduct or malfeasance in office--and no question as to either is involved here--<u>internal</u> <u>deliberations</u> (intra-organizational advisory opinions, recommendations, tentative plans and proposals, minutes of committee meetings, oral advice, et cetera), as distinct from official <u>actions</u>, must, in the public interest, be held confidential for the purpose of encouraging candor on the part of officials and employees in speaking their minds freely and uninhibitedly.

"The report that you have had prepared contains over one hundred quotations excerpted from the Federal Open Market Committee minutes, some of them of considerable length, plus selective but extensive accounts of conversations in literal or lightly paraphrased form. These quotations and paraphrasings

"are clearly inconsistent with our request, made in my letter of July 21, 1961, turning over the minutes to you, that these minutes not be disclosed 'in whole or in part.' Moreover, your document does not reveal a single policy action by the Open Market Committee that was not recorded in the Annual Report of the Board of Governors for 1960, along with the economic circumstances of the action, the votes of the Committee members, and the underlying reasons why the action was taken.

"There is no question here of a denial of information to the Congress: your request for opportunity to examine the minutes of the Open Market Committee was granted more than a year ago. Neither is there question of hostility to criticism nor of unwillingness to improve upon the presentation of the Committee's policy record in the Board's Annual Report; the Committee in fact is earnestly striving now to effectuate further improvement.

"The decision of your Committee in this instance will have implications for the Judicial and Executive branches of the Government, other governmental agencies, and the committees of Congress, including your Committee. It seems to us that to publicize to the world without a substantial time lapse the pre-decision discussions and conversations in any of these meetings would serve to institute a procedure--one virtually certain to result either in weakening internal debate for the sake of the public record or in weakening the record for the sake of the debate--that would do public mischief rather than public good.

"For the reasons stated, the Federal Open Market Committee believes that to publish at this time the minutes of the internal discussions preceding its 1960 actions--in whole or in the form of the proposed report--would be contrary to the public interest. We therefore repeat our request, made in my letter of July 21, 1961, transmitting the 1960 minutes to your Committee, that you hold their contents in confidence."

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, October 2, 1962.

The meeting then adjourned.

Secretary