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, December 4, 1962, at 10:15 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, Shuford, and Swan, Presidents of the Federal Reserve Banks of Richmond, St. Louis, and San Francisco, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, 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. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Eastburn, Ratchford, Baughman, Jones, Tow, and Green, Vice Presidents of the Federal Reserve Banks of Philadelphia, Richmond, Chicago, St. Louis, Kansas City, and Dallas, respectively
Mr. Lynn, Assistant Vice President, Federal Reserve Bank of San Francisco
Mr. Sternlight, Manager, Securities Department, Federal Reserve Bank of New York

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 November 13 through November 28, 1962, and a supplementary report covering the period November 29 through December 3, 1962. Copies of both reports have been placed in the files of the Committee.

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

The money market has continued to be quite steady in the period since the last meeting of the Committee, with most trading in Federal funds again in the 2-3/4 - 3 per cent range. In the latter part of the recent period the tone was slightly easier than in the early part, apparently reflecting a tendency for reserves to be redistributed in favor of banks in New York and other money centers. There also seemed to be some tendency for country banks to part more willingly with excess reserves than was the case earlier in the month. However, after-the-fact revisions in reserve statistics have been so substantial recently that we will not know for certain whether this is so until the revised data for the past week are available several days from now.

While the money market has remained generally steady, Treasury bill rates have edged a little higher in the past three weeks. This seems to be mainly a result of seasonal forces that are if anything a little later and milder than usual. Partly as a result of these forces and of further Treasury offerings of bills, dealer positions in these obligations have been around the highest point since last June. In the past few days the absence of System purchases of bills--at a time when dealers, with their heavy positions, were looking forward hopefully to such purchases--has also contributed

to the higher level of bill rates. However, there is also a feeling in the market that the respite from downward pressures on bill rates may be rather brief, for once we have passed the mid-month dividend and tax dates net corporate buying may return to the market.

At the same time that the absence of System bill purchases contributed to the modest rise in bill rates, the System's purchases of coupon-bearing securities has helped the note and bond market to adjust to a recent improvement in business sentiment which probably would otherwise have put prices somewhat lower and yields somewhat higher than they are now. In the course of this adjustment, while absorbing only a relatively small part of total dealer sales, the System's purchases have helped to lighten dealer inventories and thus left the market in a much better technical position to cope with what may be a continuing adjustment, for underlying bond market psychology remains cautious and hesitant in the current period of reassessment of the business outlook.

I should also mention to the Committee that the Treasury plans to build up its balances at the Federal Reserve Banks, gradually and as opportunities arise, to the neighborhood of $1 billion from the present level of about $500 million. The Treasury, for balance of payments reasons, has raised more cash than called for by immediate cash needs, and hence has been carrying unusually high tax and loan account balances in its commercial bank depositories. For the first ten months of 1962, for example, the Treasury's balances averaged about $1 billion above the average for the same period in 1961; and for extended periods within that ten months its balances have been $2 billion or $3 billion above year-earlier levels. Its balances now are still above normal, although less so than earlier in the year, and the Treasury apparently stands as ready now as it was earlier to issue more short debt and to build up its balances if this should seem necessary to shore up the short rate. Under ordinary conditions, the Treasury's balances both at the Reserve Banks and at the commercial banks are generally maintained at minimum working levels. But under the unusual circumstances that have prevailed for the past year or more and that may well continue to prevail as long as the short rate remains a problem, the Treasury believes it reasonable and appropriate that at least a part of its excess balances be lodged with the Reserve Banks, rather than have all of the excess held by the commercial banks.

If $500 million of the balances in the commercial banks are to be transferred to the Reserve Banks, that amount of reserves will of course be absorbed. In order to replace these reserves, we would purchase an equivalent amount of securities, or, more likely, refrain from making sales that we would otherwise undertake. The net of the matter thus is that after the Treasury balance in the Reserve Banks is built up to around $1 billion, we will hold in the System's portfolio about $500 million of Government securities that we otherwise would not have held. Virtually all of the interest on these securities will be paid by the System to the Treasury, while if the securities were held by the public the Treasury would recapture, via taxes, a much lesser percentage of the interest. Thus the planned build-up of the Treasury balance at the Reserve Banks can be viewed as a means of reducing the net interest cost of the unusually high balances that the Treasury has been carrying for balance of payments reasons.

The Treasury is of course aware that the System will end up holding more securities than it otherwise would have held, in order to offset the reserve effect of its higher balance, and the Treasury is also aware that this could partly offset the initial rate effects for which its increased borrowing was undertaken. But the offset would probably be minimal and it is a price that the Treasury is willing to pay.

As I indicated earlier, the balance at the Reserve Banks will be built up gradually, and because of the reserve implications of the plan, it has been agreed that the timing of the build-up will be left in our hands. We plan to make a start on this build-up, as an alternative to some sales, in mid-December, when current projections suggest that we shall have to absorb reserves; and we plan to build the balance up further in January.

It is also understood that the System is to have the major voice in the determination of short-term variations around the $1 billion level--since otherwise there might be a situation in which "open market operations" could be conducted to a significant degree by variations in the Treasury balance.

The discussion that followed related mostly to Mr. Stone's report about the plan of the Treasury gradually to build up its balances at the Federal Reserve Banks to amounts in the neighborhood of $1 billion. In reply to a question, Mr. Stone said the intent would be to build up the

balances at times when market factors were supplying reserves. Therefore, the build-up would serve as an alternative to System sales of securities. He noted that if the System sold securities it would be difficult to specify where the reserve impact would ultimately fall. It would also be difficult to specify where the impact would fall as the result of a building up of Treasury balances. In the latter case, the reserves were more likely to be drawn from the country at large through calls on commercial bank depositories throughout the country. If the System sold securities, the initial impact would fall on the central money market. The effects tended to be distributed quickly through the market, however, and it was his impression that after a few days the two reserve-absorbing procedures would have an almost indistinguishable impact.

Mr. Mills observed that the Treasury plan would not do anything to solve a problem that had been discussed at some length, namely, what he believed to be the deflationary influence of the Treasury's drawing more funds out of the financial community than it otherwise would draw, in order to support the short-term rate. Now it appeared that there was to be a backing and filling, with no foreseeable resolution of the problem.

Question was raised as to the reason for the Treasury decision being made at this particular time, and Mr. Stone commented in terms of the Treasury being able to say that in this manner the interest cost of

the extra amount of outstanding debt was reduced. Chairman Martin noted that the Treasury had been considering the matter off and on for some time, since its balances had begun to run substantially above the usual levels.

Asked for comment on the implications of his remark that the Federal Reserve was to have a major part in determining variations of the Treasury balance around the $1 billion figure, Mr. Stone observed that a Treasury balance of about $500 million, spread among the Federal Reserve offices, was a practical minimum. The balance could be reduced temporarily to $400 million, or even $350 million, without serious risk that a large check would be presented at any office when insufficient funds were on hand, but the balance could not go much below $350 million without incurring that risk. Therefore, $100-$150 million was the maximum amount by which the Treasury balance could safely be drawn down. However, if the balance was $1 billion, the amount by which it could be drawn down would be far in excess of $100 million. If it could be drawn down $500 million or $600 million at the Treasury's initiative, that would amount to supplying and absorbing major quantities of reserves through fluctuations in the Treasury balance. The Treasury recognized, therefore, that action to vary the balance around the $1 billion level was a matter in which the Federal Reserve should have a major voice. The whole approach was that variations around the new higher level should be no greater than the variations around the lower level.

Question was raised about the effect of the Treasury plan on the short-term rate, and Mr. Hayes commented that he thought an upward rate effect was accomplished by the Treasury when it increased its balances by selling more bills, for reasons related to the balance of payments, than it otherwise would have sold. The new plan represented to some extent a dilution of the original effect, but it was a price that the Treasury--and Mr. Hayes himself--felt was legitimate. The Treasury had given the Federal Reserve a major assist in terms of maintaining the short-term rate by its original action. Chairman Martin agreed that the execution of the present plan would not appear to envisage affecting the short-term rate. It simply represented a Treasury judgment on the most appropriate method of handling its enlarged balances.

Turning to a different subject, Mr. Mitchell noted that System purchases of coupon issues in November apparently amounted to a record high for the past two years. He asked Mr. Stone if the latter felt that under the present Committee directives he would be in a position to switch from short-term securities to coupon issues in order to achieve the rate effect to which the Committee had subscribed. In replying, Mr. Stone indicated that purchases of coupon issues during the past few weeks had been made primarily as a means of minimizing or avoiding purchases in the bill area. The relative amounts of purchases of coupon issues of various maturities had depended on the

availability of particular issues in the market. Mr. Mitchell asked whether this had disturbed the market in November, and Mr. Stone replied in the negative. Mr. Mitchell then elaborated on his original question by saying that he was seeking to ascertain whether it was the Manager's understanding that if the Committee continued to subscribe to its present policy with respect to maintaining the short-term rate he was free to switch out of bills to coupon issues at his discretion in order to help meet the Committee's objective. Chairman Martin said he thought the Committee's authorization made it clear that the Manager could do so, and Mr. Stone agreed.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities during the period November 13 through December 3, 1962, were approved, ratified, and confirmed.

Before this meeting there had been distributed to the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period November 13 through November 28, 1962, together with a supplementary report covering the period November 29 through December 3, 1962. Copies of these reports have been placed in the files of the Committee.

In comments supplementing his written reports, Mr. Coombs discussed recent and prospective changes in the U. S. gold stock,

along with developments in the London gold market. He noted that foreign exchange markets had been fairly quiet during the past three weeks, but added that within the past few days the German mark had begun to strengthen rather sharply against the dollar, this being particularly noticeable yesterday afternoon in New York. Accordingly, the System, after consultation with the German Federal Bank, had moved in to moderate the rising tendency of the mark by selling $4-1/4 million of marks in the New York market. There would be further consultation today with the German Federal Bank to make plans for dealing with the situation, which might reflect year-end window dressing by German banks.

Mr. Coombs also referred to the degree of firmness of the pound sterling, which might portend a substantial dollar accumulation by the Bank of England after the turn of the year, when sterling would be in seasonal strength. In the circumstances, he foresaw that the System might want to draw upon its swap arrangement with the Bank of England, and conceivably it might want to seek some enlargement of the swap facility. The System might be presented with a question as to how deeply it would want to become involved in drawing under its swap arrangements, and on how broad a front.

Mr. Coombs noted that year-end window dressing was keeping the Swiss franc close to its ceiling. This had prevented the System from accumulating Swiss franc balances against its swap liabilities,

which amounted to $105 million. If foreign confidence in the dollar was maintained--if the reaction to U. S. balance of payments figures was not too adverse--he felt there was a reasonable chance that the Swiss franc would weaken after the turn of the year and the System would be able to clean up fairly quickly its outstanding drawings of that currency under the swap arrangements with the Swiss National Bank and the Bank for International Settlements. Mr. Coombs pointed out that the Treasury's action in converting certain short-term Swiss franc liabilities into bonds would be helpful to the Federal Reserve, giving it a first call on whatever Swiss francs might become available. Of course, if there should be a deterioration of confidence in the dollar, the System might experience difficulty in unwinding its swap contracts. If so, the System would have to face the question whether to renew the arrangements, perhaps several times, or liquidate them and let the Treasury attempt to handle the problem through the issuance of Swiss franc obligations.

Turning to the Canadian situation, Mr. Coombs noted that last Friday the Bank of Canada prepaid an additional $50 million under its swap with the Federal Reserve, leaving $75 million outstanding. He then discussed circumstances bearing on whether the Bank of Canada might offer to repay the remaining $75 million on or before the due date, December 26, or request an extension.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period November 13 through December 3, 1962, were approved, ratified, and confirmed.

Mr. Coombs then stated that he had three recommendations to present to the Committee at this meeting.

First, he recommended that the $50 million swap arrangement with the Netherlands Bank, which would mature December 13, 1962, be renewed on the same terms and conditions for three months.

Without objection, the three-month renewal, as recommended by Mr. Coombs, was authorized.

Second, Mr. Coombs referred to the Italian situation, saying that Italian commercial banks had borrowed heavily in the Euro-dollar market in November, resulting in an increase in reserves of more than $140 million. In view of the low gold ratio, this was a serious matter for the Italian authorities. The U. S. Treasury had utilized the full amount (about $30 million) of its existing lira balances to absorb part of the inflow and had issued another $50 million of lira-denominated bonds to the Italians. In this context, Mr. Coombs said, he had discussed with Bank of Italy officials the possible desirability of increasing the outstanding lira-dollar swap arrangement between the Federal Reserve and the Bank of Italy from $50 million to $150 million, which would be more in line with the pattern of payments swings. Over the longer pull, he felt that a swap arrangement at this level would be

desirable, and the Bank of Italy had indicated that it probably would be agreeable. Mr. Coombs noted that there might be some occasion, over the next two or three months, to effect a small or medium-size drawing under the swap. He was hopeful that the Italian situation might be drawing into closer balance, and he thought there might be some benefit in the use of swap facilities in the Italian situation in contrast to further use of U. S. Treasury certificates and bonds.

> Without objection, the negotiation of an increase in the standby swap arrangement with the Bank of Italy from $50 to $150 million, as recommended by Mr. Coombs, was authorized.

Turning to his third item, Mr. Coombs recommended that the Committee authorize a $50 million three-month krona-dollar swap arrangement with the Bank of Sweden on the usual terms and conditions. He explained that at the most recent meeting of the Bank for International Settlements he had had a conversation with the Governor of the Bank of Sweden regarding the network of Federal Reserve swap arrangements, and that the Governor had subsequently indicated by cable that the Bank would be interested in entering into a $50 million standby swap. Mr. Coombs pointed out that the Swedish krona was a fully convertible currency under the definitions of the International Monetary Fund, and that the Bank of Sweden maintained a low gold ratio in relation to dollar reserves.

Without objection, the negotiation of a $50 million three-month krona-dollar standby swap arrangement with the Bank of Sweden, as recommended by Mr. Coombs, was authorized.

In connection with the foregoing item, Mr. Coombs noted that the Governor of the Bank of Sweden in effect represents the Scandinavian countries at meetings of the Bank for International Settlements. His cable expressing interest, on behalf of the Bank of Sweden, in a swap arrangement also had suggested that the central banks of Norway and Denmark might likewise be interested. Mr. Coombs pointed out to the Committee, however, that the currencies of Norway and Denmark were not fully convertible under the definitions of the International Monetary Fund. He suggested that negotiations not be entered into with those central banks, at least for the moment.

There followed discussion concerning the content of the IMF definition of a fully convertible currency and concerning the desirability of using that standard as a basis for determining whether to enter into swap arrangements. It was noted that all swap arrangements thus far had been with central banks of countries whose currencies were fully convertible and that, of the European countries, Sweden was the only one with a fully convertible currency that the Federal Reserve had not covered in its network of swap arrangements. There were some Latin American countries whose currencies were fully convertible under the IMF definition, but those currencies were not important in international transactions.

Mr. Hayes noted that Sweden was a larger country, and more important industrially, than Norway or Denmark. He had felt, in general terms, that swap arrangements should be confined to currencies that were to some extent important international money market currencies. The Swedish krona, he felt, was more important than the Norwegian and Danish currencies from this standpoint.

Mr. Hayes added that he felt the Federal Reserve had two possible courses. It could be rather restrictive and confine swaps to the central banks of those countries that were of some importance from the standpoint of this country's international payments position. Or it could take a more liberal view and extend the network of swap arrangements to all countries that managed their affairs fairly well. If the second course were followed and swap arrangements were entered into with Norway and Denmark, for example, he was not sure but that logically the System would have to go further and consider swap arrangements with various other countries.

Mr. King indicated that he had some question as to the criteria that should most appropriately be used. It might be, he suggested, that in the long run the System's interests would be served best by considering swap arrangements with individual countries on a case-by-case basis as the occasion arose, rather than by establishing general criteria, whether according to the standard of full currency convertibility or on the basis of size of country, importance

of currency internationally, or other arbitrary definitions. He would have some uneasiness about not looking further into the possibility of swap arrangements with the central banks of Norway and Denmark. Therefore, he would suggest that any further question in this regard from the Governor of the Bank of Sweden might be handled along the lines of indicating, without commitment, that the situation in respect to Norway and Denmark was receiving further study.

The matter was left on that basis, and Mr. Furth was requested by the Chairman to have a memorandum on the subject prepared for the Committee.

It was suggested that the aforementioned memorandum contain information on the conditions that satisfied the IMF requirements of full convertibility so that the Committee might consider whether this would constitute an appropriate criterion for determining whether to enter into swap arrangements.

Mr. Mills referred to the several staff memoranda that had recently been distributed on the economic and financial position of various countries, in connection with the consideration of swap arrangements. He suggested that it might be helpful in the future to include information on the external public debt of the particular country, including the servicing of such debt.

Mr. Mills inquired about developments in respect to the European Monetary Agreement, and Messrs. Coombs and Young replied in some detail,

the latter indicating that the Agreement was being extended for a year under an arrangement that he described. He added that the staff would follow developments in this regard and that informational memoranda would be distributed from time to time.

The Chairman then inquired whether there were further questions or comments in the area of System foreign currency operations. None being heard, he called for staff reports on economic and financial developments, to be followed by the usual presentation of comments and views around the table.

Mr. Noyes presented the following statement on economic conditions:

> A wide range of discomforts lies in wait for anyone who is required to make an appraisal of the economic situation at regular intervals. One becomes acutely sensitive to all sorts of environmental changes. My own appraisal of the basic situation has not changed substantially from the one I presented six weeks ago, except that now I have to try to determine the effect on its validity, if any, of the widespread acceptance of this point of view, or an even more optimistic one.
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> If one sets aside, for the moment, the important changes in people's attitude toward the future, the actual developments in recent weeks seem only very moderately balanced on the favorable side--a condition that has prevailed for some time. For example, after its somewhat disappointing performance in October, there is a chance that the industrial production index may edge up a little in November. On the other hand, while it did not move by an amount we regard as statistically significant, unemployment was back up to 5.8 per cent in November. Another set of figures scheduled for release shortly--the Commerce - SEC plant and equipment expenditure survey--presents the same sort of picture. At an annual rate of $38.3 billion, such expenditures in the third quarter were a little more than previously estimated. They

are expected to remain at the same level in the current quarter and then decline a little in the first quarter of next year. In other words, there was not enough change from the pattern suggested by the earlier McGraw-Hill survey to justify a modification of one's appraisal in either direction.

Turning to retail sales, on the basis of the weekly data we guess that the improvement in other lines more than offset a decline in auto sales from the advanced October rate, so that the seasonally adjusted rate will be up 1 per cent or so. But, this doesn't represent an increase over the level we have been looking at, because October is being revised downward by about the same amount.

Prices remain generally stable, most of the brief upward flurry in commodities following the Cuban crisis having been reversed except in the case of a few of Far Eastern origin. While steel producers have been talking about selective increases, the price of primary aluminum has been cut by two large producers. The consumer price index dropped back one-tenth of a per cent in October, after a rather sizable rise in September due primarily to the withholding of Mid-western beef.

It is hard to see how stimulus for expansion to levels substantially above those now prevailing could come from indigenous factors. Automobile sales and production will do well to maintain their present level. Even the most optimistic forecasts for residential housing envisage some decline from the October rate. The immediate prospects for plant and equipment spending are sustaining at best. Strength of demand for nondurables seems to be barely maintained. Hence, we must look primarily to Government, the slow steady growth of service expenditures, and perhaps some improvement in sales of household durables to provide even moderate expansion, unless there is some major exogenous stimulus. The possibility that such a stimulus can and will come from a large and early tax cut is widely anticipated and, in fact, is already incorporated in expectational patterns. In an age of calculated risks, the greatest risk at the moment seems to me to be that no more than normal delay in the handling of a proposed tax cut, coming at a time of seasonal slack, may result in the collapse of a modest expansion based importantly on the assumption of its prompt enactment.

The economy is presently receiving some mild stimulation from the generally more optimistic outlook of businessmen and from the usual tendency not to allow fully for the seasonal nature of the improvement that comes in the late fall and early

winter. These are highly transitory influences that can vanish quickly with a heavy snowfall or a discouraging political development. It is altogether possible that we may get some strengthening of the underlying economic situation, but there is no hard evidence that this has occurred as yet.

Mr. Koch presented the following statement on financial developments:

Probably the most relevant figures for current monetary policy determination that have become available in the financial area since this Committee's last meeting are the ones on bank reserves and the money supply. These data all suggest that the degree of ease that has prevailed in money and banking markets in recent weeks has achieved for this period what I take to have been one of the Committee's main objectives, namely, a sizable expansion in the monetary base.

Looking first at bank reserves, you will recall that since mid-June the staff has been using a three per cent secular growth trend in our guideline figures for required reserves behind private deposits. In the third quarter, actual required reserve expansion was substantially below this rate of increase, but in October actual growth came up to the guideline and in recent weeks it has been somewhat above the three per cent standard.

Turning to the narrowly defined money supply, it, too, grew sharply in October and November from the plateau at which it had settled for many months earlier. It is true that part of this recent growth in the money supply, as well as the growth in required reserves behind private deposits, was due to a drawing down of Government balances to more normal levels, but part also was due to a sharp increase in bank credit, particularly in bank loans. Time and savings deposits of commercial banks are also continuing to increase sharply at a rate about midway between the very high first quarter rate and the reduced rate that prevailed during the summer and early fall.

The recent sharp expansion in bank loans is difficult to explain. Bankers tell us that demands for financing are still disappointing. Moreover, business financial statements show a growing availability of internal funds. Yet in October and November combined, total bank loans increased at a seasonally adjusted annual rate of about 12 per cent and business loans at an 8 per cent rate. Both of these rates of increase are

considerably in excess of those in production and employment and no doubt reflect, in part at least, a switch out of capital market financing.

Indeed, the capital market is the only area of financing that has appeared light in recent months. Security offerings by corporations, for example, are likely to total only about $2-1/4 billion in the fourth quarter, 25 per cent below the amount in the comparable months a year ago. State and local security financing is expected to equal about $1-3/4 billion in the current quarter, 20 per cent below last year's total. Mortgage financing, however, continues very large, and the capital markets have absorbed, although not without some interest rate effects, the substantial debt lengthening recently accomplished by the Treasury through both its advance and regular refundings.

Interest rates have been particularly sensitive for some time now to changing expectations as to prospective domestic economic developments, the status of international political negotiations, and the budgetary position of the Federal Government. Recently some firming of rates has taken place, with more optimism existing concerning both the economic situation and international affairs, and with more awareness developing of the possibility of sizable tax reductions and a larger Government deficit next year.

Thus far the interest rate firmness has been concentrated largely in the short-term area. Whereas 3-month Treasury bills, currently at a 2.86 per cent yield, are now 17 basis points above their recent low, yields on 3 - 5 year Treasury bonds are now 5 basis points higher and yields on long-term Treasurys are 2 basis points higher. Yields on corporate and State and local bonds have also risen slightly recently, reflecting in part the major stock market rally that has occurred. The Standard and Poor's index of common stock prices is now about 16 per cent above its recent low in late October and half way back to its all-time peak a year ago.

I suspect that the firming of intermediate and long-term Treasury bond yields that has taken place in recent weeks has been due mainly to changing market forces and expectations, but our own activity, coupled with that of the Treasury, in seeking to bolster short-term Treasury bill rates has no doubt had some effect on the longer term sectors of the interest rate structure. As long as the market feels that we will do all we can to maintain short-term interest rates in their current yield range, I doubt if long-term rates can fall much further. Yield spreads are already quite narrow, particularly for a period of easy money.

In the very short run, our most recent purchases of coupon issues rather than bills to provide a sizable portion of the late November-early December reserve needs have tended to keep longer term yields from rising. Substantial purchases of coupon issues have been accomplished without major yield impact, but at a time when some investors as well as dealers wanted to shorten their portfolios of Government securities.

Looking ahead, from the middle of December seasonal factors will be working for lower interest rates, as demands for financing are normally low and the flow of investment funds is normally large in the early months of the year. Moreover, market expectations about improving economic developments may be exaggerated. A tax cut is by no means a certainty; nor can we be sure that the most feasible tax cut politically would have the expected expansionary effect on the private economy.

The seasonal factors have been on our side recently, not only with regard to interest rates but also probably with regard to the expansion in bank reserves and the money supply. I cannot help but feel that our seasonal adjustment factors do not completely allow for the market demand for bank loans and consequent increase in deposits that normally occur in the fall, particularly in an expansion phase of the business cycle. It will be recalled that the money supply also increased substantially late last year. When the loan demand decreases in the seasonally slack months early in the year, we will have to rely mainly on bank purchases of securities to increase total bank credit and the money supply. Then will come the real test as to whether the current level of free reserves and the recently prevailing tone in money markets, as influenced by one of our prime objectives, namely, keeping up short-term interest rates, will be stimulative enough to the banking system to encourage further expansion in the monetary base.

Encouragement of further expansion in our monetary base strikes me as particularly important at a time like this when many economists agree that the main things wrong with both our domestic economy and our balance of international payments are essentially not monetary in nature. In such a situation, we might well elevate to an even higher position than usual in our range of monetary policy objectives, the expansion of bank reserves and the money supply at a rate approximately equal to a sustainable growth rate in production and employment.

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

> For November, our fragmentary and preliminary weekly figures indicate a sharp drop in transfers to foreigners of gold, foreign convertible currencies, and dollars. The estimated total for the month is $200 million, less than one-fourth of the October figure and less than half of the average for the third quarter.
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> In computing the officially announced payments deficit, the figure will be reduced by various statistical adjustments, and in fact will show no net transfers at all for November, provided that the final unadjusted data agree with our tentative estimate. But whatever the intrinsic merit of those statistical adjustments, the adjusted official figures will not in any meaningful way be comparable with data for previous years.
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> The November results are a welcome confirmation of the view expressed at the last Committee meeting that the large increase in the October deficit was due to temporary factors. Those results apparently reflect mainly two developments: First, the extraordinary movement of short-term funds to Canada seems finally to have come to an end, although the flow of investment capital has continued. Second, Japan has begun to repay the large sums it borrowed in New York last year.
>
> There are still no indications that the more basic accounts of our payments balance have decisively improved. In fact, our imports apparently have continued their upward trend, in spite of the lack of a similar trend in our domestic economy. The delay in reporting export figures makes it impossible at this time to state whether our exports have recovered from their mid-summer slump.
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> Developments abroad show further improvement in business sentiment in Continental Europe, and further expansionary measures in Britain and Japan. Both developments should brighten our export prospects. But there is also a growing conviction that the Europeans will be able to keep wage and price increases under control. This is good news from the point of view of international financial stability. But it is less encouraging to those of us who hope that a continuing slight deterioration in the competitive position of European export industries may in due time help to reduce Europe's chronic payments surplus and thereby also help to solve our own payments problem.

> Confirming the forecast made by Mr. Coombs at the last meeting, the gold situation has remained better than our payments position would seem to warrant. In November, total U.S. gold holdings declined on balance only $10 million, in spite of continued gold sales, especially to France and Austria. But the decline would have been many times as large if the U.S. Treasury had not used borrowed foreign exchange funds to buy $30 million of gold from Switzerland and to relieve the Swiss and the Italian banking systems of $80 million of "excess" dollar holdings. The System used $10 million of its Belgian franc assets acquired under our swap with the National Bank of Belgium for a similar purpose.
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> As Mr. Coombs has reported, Canada has unwound a further $75 million of its swaps with the System and the Bank of England. This leaves Canada with $100 million in outstanding swaps and $300 million in Fund drawings. Repurchase of the Fund drawings will have to be made mainly in Continental European currencies. Canada will presumably acquire the bulk of these currencies in the New York market, and this may indirectly lead to a further drain on our gold stock.

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

> Perhaps the most significant development on the domestic scene in the last few weeks has been the distinct improvement in business atmosphere. Swings in sentiment are often more pronounced than those in the underlying statistics, and the latest business data merely seem to confirm the opinion many of us have held right along that the economy is moving very gradually upward, with no real evidence to date pointing either toward a recession or toward a strong upsurge. Of course, the better business sentiment now clearly evident is a good sign not only because the businessmen's judgment as to their prospects may turn out to be more accurate than the more cautious views that have been voiced by many economists, but also because better sentiment may have some solid effects on spending decisions and hence on future activity. The stock market's performance has probably both reflected and encouraged the improvement in atmosphere, which has also been cheered by the apparent increasing likelihood of a tax reduction in 1963. Already retail trade data, including those for automobiles, suggest that the improved sentiment extends to consumers. Other favorable straws in the wind have included a substantial rise in personal income in October, the prospect of sizable

Government insurance dividend payments in January, the failure of recent data to support earlier signs of weakness in residential construction, and a better trend in new orders for durable goods.

It is very hard to make an adequate analysis of the latest balance of payments indications because of the very wide week-to-week fluctuations and the absence of up-to-date information on the principal components. While the November deficit will undoubtedly be much smaller than the spectacular October figure, partly because of the unwinding of window-dressing operations by Canadian banks, the outstanding development, and a very sobering one, is that the over-all deficit for the year to date is only a little short of the total deficit for the year 1961. In view of the earlier conviction, prevalent both here and abroad, that 1962 would show significant progress over 1961, there is bound to be considerable disappointment with the actual results, even if special official payments to the U.S. and other special arrangements before the year-end make possible some net improvement over last year. It is significant that if such special transactions as debt prepayments are excluded, the over-all result this year will probably show appreciable deterioration from last year. Of course we can find much satisfaction in the calm performance of the exchange and gold markets in recent weeks. Various special financial arrangements and the excellent spirit of cooperation among the leading central banks have contributed greatly to this state of affairs; but I fear we may be approaching the time when these central banks will simply be unwilling to add substantially to their uncovered dollar balances, when our swap facilities will be approaching exhaustion, and when our continuing substantial balance of payments deficit will therefore impinge directly on our gold stock.

As we view the latest data on credit we find that the behavior of both total bank credit and business loans has been stronger in the last couple of months than might have been expected seasonally. The money supply has risen sharply, partly because of a substantial drop in Government deposits, and time deposits continue their steep advance. Despite some slight decline in bank liquidity in New York during November, which might be due in part to the November refunding, the over-all liquidity of the country both in and outside of the banks continues ample. Seasonal pressures have been helping to maintain a firm short-term rate structure, and for the time being the problem of covered rate spreads between New York and London has become much less acute. We should have in mind,

however, the probability that after mid-December seasonal factors in the money market will be working against us, and it may be considerably harder to sustain the current market rate structure.

At the last meeting I urged the Committee to make a moderate move toward lesser ease, feeling as I do that although a solution to our very serious international problem calls for continued vigorous action on many fronts, this in no sense excuses monetary policy from doing what it can to help. I still believe that this is the direction in which we should be moving, that the improved business sentiment and outlook provide us with a better opportunity than we had a few weeks ago, and that it would be decidedly prudent to try to make some further progress toward a firmer rate structure before seasonal factors turn against us. I would emphasize, however, that what I am talking about is a modest change in policy, involving an effort to hold the Federal funds rate more steadily at 3 per cent and to encourage short-term bill rates closer to that level, which would probably mean letting free reserves decline appreciably below the average level of $400 million or higher that has prevailed now for many months. The Manager should, I believe, continue to be guided principally by the tone of the market; and it might be helpful to continue to make as active use as possible of operations in the intermediate and long-term areas. I would not advocate at this time an increase in the discount rate, preferring to wait until we have observed the results of a modest firming in open market policy and until we have a clearer idea both of the probable size of the year's over-all deficit and of the probable impact of this figure both here and abroad. The Committee might be interested to know that some of our Directors have recently expressed serious concern over the failure of the System to do more in recognition of the very serious international situation and have suggested that a prompt increase in the discount rate might be appropriate. I have persuaded them, however, that such action would be premature, that they should defer it, and that, in my judgment, open market policy would be a more appropriate area for an initial move in the direction of less ease.

The directive should, I believe, be modified somewhat if the Committee is willing to make a modest policy change of the kind I am proposing. I also believe that we might remove the reference to the emergency situation since its force would merely be weakened by routine repetition after the situation which evoked it has changed. I would suggest that the following wording be considered:

It is the current policy of the Federal Open Market Committee to encourage moderate further increases in bank credit and the money supply, while aiming at money market conditions that would minimize capital outflows internationally. This policy, while recognizing the recent improvement in business sentiment and the continuing serious deficit of the United States balance of payments, takes into account the unsatisfactory level of domestic activity, the continuing underutilization of resources, and the absence of inflationary pressures.

To implement this policy, operations for the System Open Market Account during the next two weeks shall be conducted with a view to providing a moderate expansion of bank reserves and to maintaining a firmer tone in money markets.

Mr. Ellis reported that in New England there was a rather general expectation of modest further growth in economic activity during the first part of 1963. Businessmen reported a trend toward an increasing volume of new orders, and the Reserve Bank's survey of 1963 capital spending plans of New England manufacturers suggested a 10 per cent increase over the current year's level. Retail sales were strong, with expectations for a good Christmas buying season. However, October and November statistics provided somewhat less basis for optimism. For example, although nonfarm employment was up slightly in October, manufacturing employment was off, with manufacturers of durables showing a year-to-year loss. Seasonally adjusted estimates of unemployment in October were being marked up slightly from the 5.5 per cent September level. As of mid-November, commercial and industrial loans were continuing the sharp expansion that had been evident since mid-summer.

With demand deposits remaining about level during the past year, First District banks had moved from consistent sellers of Federal funds to the position of substantial net buyers. Representatives of certain large insurance companies operating on a national scale expressed the view that there was no crisis immediately ahead in the construction field. However, they expressed some concern about the effects of "ease compounded by ease."

As to policy, Mr. Ellis indicated that he found himself in substantial agreement with the views of Mr. Hayes. In his opinion, a gradual move should be started toward a position of continued but lessened ease. The domestic economy was strong and was expected to become stronger; and this situation would not seem to require a continuation of the same degree of ease that had been considered necessary over a period of many months for the purpose of stimulating the economy. Evidence of domestic economic strength was seen in new orders, retail sales, and related series. At the same time, as pointed out by Messrs. Hayes and Furth, the balance of payments picture was such that monetary policy should be doing what it could in a supporting capacity. The degree of monetary ease in recent months had achieved a sizable expansion of reserves and a substantial expansion of loans and investments. There had been a 7.5 per cent rate of increase since August in required reserves against private deposits, with the result that required reserves were now above the so-called growth guideline.

The effect of the policy that had been in effect was a run-up in reserves substantially more rapid than would be warranted on a continuing basis, and a somewhat lower level of free reserves should be adequate to support a sustainable rate of growth.

Mr. Ellis commented that a shift of emphasis such as he had described might suggest a change in the policy directive. Yet it was such a modest shift that no substantial change in the directive probably was required. However, he would eliminate the reference to the emergency situation presented by the Cuban crisis and reserve the use of such language for later occasions if necessary. Also, he would like the directive to recognize that there had been a more rapid growth of reserves recently than he believed was warranted on a continuing basis. With this in mind, perhaps the word "moderate" (reserve expansion) in the last paragraph of the directive could be changed.

Mr. Ellis expressed the view that the free reserve target should be lowered to approximately $300 million. The target for the Federal funds rate should be close to 3 per cent, and bill rates should continue within the range that had prevailed recently. He would reserve any change in the discount rate for future consideration.

Mr. Irons reported that there had been no significant changes in the Eleventh District, which continued to experience a good level of business activity. While there were some mixed trends within the

over-all picture, in general the District economy was operating at a high and stable level. Most indicators of business activity showed gains thus far this year running from 4 to 7 per cent above last year. Department store trade was relatively weak in October but strengthened in November, and there was considerable optimism among retail trade people. In general, business sentiment was a little stronger than a few weeks ago. In agriculture, cash receipts from farm marketings should be about 7 or 8 per cent above last year, with increased receipts from both livestock and crops. The industrial production index fell off a bit in October, nonagricultural employment was up, and unemployment continued within the narrow range that had prevailed for some time. Construction activity continued to rise, being some 20 per cent over a year ago. There was no change in the oil situation.

Mortgage money was said to be readily available in the District, with some downward pressure on rates. Bankers considered their position adequately liquid and there had been no significant borrowing from the Reserve Bank. Deposits were up, and investments up a little. Net activity in Federal funds showed an increase in purchases, this being attributable largely to the operations of two or three banks.

Mr. Irons said he had been satisfied with the results of recent policy. Looking ahead, he felt that a drift in the direction of a little less ease might be appropriate, with any deviations on that side. There seemed to be adequate liquidity in the banking system,

and the free reserve levels that had prevailed could hardly be associated with a restrictive policy. He would look for a bill rate somewhere in the range of 2.80-2.85 per cent, and felt that the Desk might operate in longer coupon issues wherever that was advantageous. He would look for Federal funds in the area of 2-3/4 to 3 per cent, mostly at 3 per cent. While he did not attach too much weight to the free reserve figures, he would say that a level somewhat around $350-$400 million would be adequate. In summary, he would not suggest any marked change in policy, just a drift toward a little less ease. He would not change the discount rate at this time.

As to the directive, Mr. Irons suggested only eliminating the reference to the emergency situation relating to the Cuban crisis. The Committee could do what he would like to see done within the framework of the existing directive, and he would hesitate to change just a few words in an endeavor to provide some fine shading, for he did not think the directive should attempt to be that precise.

Mr. Swan said that the general situation in the Twelfth District continued much the same as reported at recent meetings. On balance, the District was experiencing a continuation of a very gradual rise in overall activity. Nonagricultural employment made another small gain in all District states in October, with improvement in all industry divisions except mining, although the increase in manufacturing employment was below the August and September gains. In terms of year-ago comparisons,

employment in durable goods industries was up in October in all but two categories, those being primary metals and lumber and wood products. Department store sales continued strong in November, and a good Christmas buying season was anticipated by the major stores.

The larger District banks had not had quite enough growth in deposits to keep pace with seasonal loan expansion, so they were under some reserve pressure. During the first three weeks of November, they were net buyers of Federal funds, and some of them borrowed--although quite moderately--from the Reserve Bank. Total time deposits showed a decline in this period because of the payout of Christmas Club accounts, even though total savings deposits continued to rise.

As to policy, Mr. Swan said he saw little reason in light of recent developments to change the opinion he had expressed at recent Committee meetings. He would agree with the observations about an improvement in business sentiment, but he did not think this provided a real basis for assuming any kind of a break-through to rapid upswing. The optimism seemed to carry the inflection that a recession was much less likely rather than that the upswing would necessarily become much more vigorous. Also, it seemed to him that the general outline of the balance of payments problem had not changed significantly. If anything, the current situation seemed slightly more encouraging, at least more encouraging than a month ago. Accordingly, his feeling would be that the Committee should continue much the same policy that it had been

following, moving--if at all--very slightly in the direction of a little more ease rather than in the direction of slightly less ease.

Summarizing, Mr. Swan said he would like to see the Committee continue to supply reserves freely, and if anything move on the side of ease rather than the reverse. It seemed to him that this would not require a change in the directive, although he would go along with the suggestion for elimination of the reference to international developments of a crisis nature. Obviously, he would not favor a change in the discount rate.

Mr. Deming reported that relatively little new statistical data on general economic conditions in the Ninth District had become available since the last meeting of the Committee, and that the available data were mixed. Nonagricultural employment in the District had inched up all year to its seasonal peak in September, but since then had declined. The drop had been mainly seasonal, but had been a bit more pronounced than last year in both October and November. This reflected partly the earlier close of the ore shipping season this year, but partly a rather sharp decline in construction employment despite favorable weather. Employment was still running higher than a year ago, however, by about 2 per cent.

District iron ore shipments totaled approximately 54 million tons this year, about the same as last year but 10 million tons less than estimated earlier this year. For comparison, ore shipments in

1953 were 94 million tons; in 1957 they were 81 million tons; and even in 1960 they totaled 65 million tons. Ore concentrates and taconite constituted a fairly heavy percentage of current shipments. Thus the decline in iron content was smaller than the tonnage figures would imply, but it still had been quite sharp.

On the other hand, Mr. Deming said, industrial output as indicated by power consumption figures was running 10 per cent ahead of a year ago. And while department store sales had been erratic, bank debit figures had been sharply expansive in recent weeks, indicating a high level of transactions. District income gains continued to show up favorably relative to national increases, with the high farm income from this year's excellent agricultural situation contributing strongly to the better than average performance.

If there was such a thing as a confidence index for the District, Mr. Deming felt that it would be fairly high and rising as the year drew to a close.

The District banking picture continued to show strength in loan and deposit growth. So far this year, loan expansion and deposit growth at city banks in the District had been much stronger relatively than that for all city banks in the United States. Loans and deposits at country banks had grown just about the same relative amount as in all country banks in the United States. Loan-deposit ratios of District banks continued to run well below their peak levels of mid-1960. They

had shown relatively little growth since their lows of a year ago, due--as the record implied--to a very strong deposit expansion offsetting the sharp loan growth. Borrowing from the Reserve Bank continued to be nominal, and the banks seemed to have ample liquidity, although the level of real liquidity might not be as high as the raw figures on loan-deposit ratios would indicate since a significant part of the recent loan expansion had been in less liquid loan categories.

Turning to policy considerations, Mr. Deming said that although the domestic economy perhaps needed no more stimulation on the monetary side, as yet he saw no persuasive reason to cut back, in any appreciable degree, on such stimulus as monetary policy was now providing. The balance of payments picture was anything but encouraging. Monetary policy should be careful to do nothing that might worsen the picture and, of course, should do what it could to help better it. He did not see, however, that monetary policy could do significantly more than it had been doing. Therefore, he would not place additional emphasis on the short rate as a policy guide and would not attempt, at any significant cost in the sense of lessened reserve availability, to force the short rate higher, or even to hold it at present levels. He would seek to minimize downward pressure on the short rate by operating, when it could be done, outside the short-term market area.

Thus, Mr. Deming said, he favored no real change in policy for the next two weeks. He would have no objection to short rates

holding where they were, or even rising slightly, but he would not push them at the cost of significantly lower free reserve levels. While he would have no objection to somewhat lower levels of free reserves, he would not seek such levels as a matter of policy, nor would he accept much lower levels as a cost of holding up short rates. This brought him to about the position expressed by Mr. Irons: possibly a "drift" down from current free reserve levels, but a very gradual drift and not a "shift" to a position of less ease, however modest such a shift might be. In conclusion, Mr. Deming said he would not favor changing the discount rate at this time.

Mr. Scanlon reported that there had been a further improvement in business sentiment in the Seventh District. Strengthening of retail sales, supported by the continued high level of automobile sales, was a key factor in this trend. Steel orders from fabricating industries increased during November and price increases, announced by a variety of firms, reflected a firmer tone in wholesale markets. Nevertheless, many business firms in the area continued to complain of sluggish orders and declining backlogs.

Employment was following the usual seasonal pattern in the District. There had been few reports of either contra-seasonal lay-offs or hirings. However, new claims for unemployment compensation during October and November were below the levels of the past four years.

Appliance manufacturers reported that they were increasing production to supply larger dealer orders. Orders for capital goods in the third quarter probably were inadequate to support a further rise in production of machinery and equipment in the current quarter. However, there had been some indications recently of an acceleration of orders for prompt delivery of some types of equipment so that the tax credit could be used as an offset to this year's income.

Net farm income in the Seventh District in 1962 very likely would exceed last year's level, but this picture might be reversed next year. It now appeared that Federal payments to farmers would be reduced in 1963 because fewer farmers would be participating in the new feed grain programs, and returns on cattle feeding were expected to decline from the current favorable level. New agricultural loans reported by District banks this fall had been substantially above last year, mainly because of larger purchases of feeder cattle at higher prices.

The strengthening of business loan demand that began in late summer had continued, Mr. Scanlon noted. Weekly reporting banks in the District increased their business loans in November, in contrast to declines in the comparable period of each of the three previous years. Durable goods manufacturers and public utilities accounted for a large part of the rise in business loans, but gains had been reported for most industry categories.

As to policy, Mr. Scanlon said that he tended to associate himself in general with the views expressed by Messrs. Irons and Deming. However, the Committee would be meeting again in two weeks, and he felt that its essential objectives could be realized by continuing current policy during that period. On that basis he would propose no change in the directive other than deletion of the sentence referring to the international emergency arising out of the Cuban situation. He would not favor any change in the discount rate at this time.

Mr. Clay commented that the performance of the nonfarm sector of the Tenth District economy in recent months bore a strong resemblance to that of the nation as a whole. Although dissimilarities were apparent, the fact that changes generally had been of small magnitude served to reinforce the view that the District and the nation had performed quite similarly. For instance, this appeared to be true of nonfarm employment, which had shown little change in recent months. Even when industrial sectors of employment were considered separately, the performance of the District and the nation were found to be predominantly alike. Moreover, the flow of personal income in District States had risen much in line with national experience.

One nonfarm indicator in which the Tenth District showed a contrasting pattern from the nation as a whole in recent months was business loans. Whereas business loans nationally had shown above-seasonal expansion in recent months, business loan growth had been

limited to seasonal proportions in the District. On the other hand, during the first seven months of the year business loan expansion in the District was unusually strong, in contrast to the nation.

Agricultural conditions had been favorable in the Tenth District this year, and agricultural output had responded accordingly. While crop acreage had been reduced sharply by Government programs, this was largely offset by excellent yields. Range and feed conditions had been unusually good in most part of the District, and livestock production had expanded to record high levels.

A large volume of marketings and somewhat higher prices had caused cash receipts from farm marketings to be well maintained. Government payments under the wheat and feed grain programs also had been large in Tenth District States. Thus, realized gross farm income would establish a new record. Production expenses also were at a peak, however, so realized net farm income would approximate that of 1961 rather than exceed it. Prospects were favorable for continued high levels of farm output and aggregate gross income, although many marginal operators continued to be confronted with financial difficulties.

Turning to policy considerations, Mr. Clay expressed the view that domestic developments in the national economy continued to need the support of an expansive monetary policy. While some indications of recent economic improvement could be cited, notably automobile sales, evidence of a basic change leading to a fuller utilization of manpower

and other resources was not yet available. On the other hand, the international balance of payments problem remained a hindrance to the appropriate execution of an expansive monetary policy, particularly as to the level and pattern of interest rates. As long as the Treasury bill rate remained as high as its recent level, the Committee was limited as to what it could do. Nevertheless, he felt it should continue to supply reserves to the banking system in sufficient quantity to enable bank credit to expand in excess of seasonal proportions. Furthermore, it should make offsetting purchases and sales of Government securities to whatever extent necessary in order to provide those reserves. The Reserve Bank discount rate should remain unchanged.

Mr. Wayne reported that Fifth District business conditions conformed in broad outline to those sketched on a national basis by Mr. Noyes. District weekly reporting banks experienced their strongest November rise in gross loans since 1958, the largest part of which occurred in business loans, with real estate and "all other" (chiefly consumer) loans assisting. District businessmen viewed the immediate future with more optimism than three weeks ago and considerably more than six weeks ago.

As to the situation nationally, Mr. Wayne noted an absence of hard facts to indicate a significant rise or decline in activity. In the circumstances, it seemed to him only logical to assume a continuation of the present sideways movement along a high plateau.

It appeared to Mr. Wayne that the Desk had been most successful in fostering a steady tone in the money market during the past three weeks. Aided substantially by the Treasury's increases in the supply of bills, the three-month bill rate had risen by 15 basis points or more and thereby had alleviated to some extent the pressure tending to drive funds abroad. The action of the Bank of England in eliminating special deposits last week should provide further assistance in this direction. The rise in the Treasury bill rate had occurred without causing any stringency in the market despite some very heavy churning as large payments were made for Treasury securities. Other short-term rates moved only moderately and yields on long-term Governments remained quite stable at comparatively low levels. All in all, he considered it a good demonstration of open market operations at their best, including skillful and discriminating purchases of longer term securities. It seemed to him that the Committee had accomplished all that it could reasonably have expected to accomplish three weeks ago. Also, over a somewhat longer period of time there had been moderate but fairly steady increases in bank credit and the money supply, trends that were listed as policy objectives in the first part of the directive. Since basic conditions in the economy had not changed and since operations over the past three weeks had been quite successful, he saw no reason for a change of policy. Therefore, he would favor renewing the current policy directive and making no change in the discount rate.

Mr. Mills said that in his opinion this was definitely a time when Federal Reserve policy should be used to encourage the improvement of public and private attitudes toward the economic situation that had been reflected in somewhat stronger business activity. Monetary policy therefore should provide a broad base of reserves as an incentive for further bank credit expansion. The record of the past three statement weeks was an object lesson, Mr. Mills said, concerning the inherent benefits of placing an adequate supply of reserves in the hands of the commercial banks. Putting the recent experience in statistical perspective, there had been a higher level of free reserves and a lower level of Treasury balances. These two statistical changes, which were reflected in a broader and more extensive expansion of bank credit, had been accomplished without any observable downward pressure on the level of interest rates. This might have been due largely to the fact that credit expansion creates some upward pressure on interest rates. Thus, a counter pressure results from a higher level of free reserves.

As to the record of the past three weeks, with the benefits that he saw in the statistical experience, Mr. Mills suggested that this had been more the result of fortunate accident than design. That was brought out by the changes in the reserve figures; when the revised statistics were published, they had shown an upward lift. In his opinion, monetary policy should continue to move as it had, adventitiously, in the direction of greater ease. This would imply no change in the discount rate and no alteration of the policy directive.

Mr. Robertson presented the following statement:

I am somewhat encouraged by the developments that have taken place since our last meeting. It seems that international financial markets have calmed down slightly, the domestic business situation is a shade brighter, and reserve ease has been sufficient to promote further gradual monetary growth.

I must say that I am particularly gratified by what appears to have happened--and what did not happen--in the international financial arena. These latest weeks have demonstrated that international interest rate differentials can move down as well as move up, and that capital can move in as well as move out, with temporary fluctuations being equilibrated by the workings of forces other than short-term adjustments in our own general monetary policy. Moreover, I judge our problems will be rendered somewhat easier over the longer run by the official downward adjustment of the Canadian discount rate, as well as official easing actions in Japan and the United Kingdom.

All of these developments confirm the wisdom of our holding to a steady monetary policy, rather than steering to the tighter side, through flurries that arose a month or so ago.

I do not mean in any sense to sound complacent regarding our situation. I still think that, while our international competitive position fundamentally is favorable, our domestic situation is fundamentally unfavorable. Business activity continues to lack the vigorous upthrust that our underutilized resources, human and material, could support. There are some signs of improvement in individual industries, but we have as yet no conclusive evidence of the spread of expansionary influences more generally through the economy. This is precisely the kind of economic environment in which I think continued monetary growth is badly needed, in the interest of encouraging more robust spending inclinations wherever they may be appearing. I think it is quite feasible to provide sufficient reserve ease to gain some further additions to the money supply, without overwhelming financial markets or generating sloppy money conditions. Indeed, the period between now and the end of the year, with its strong seasonal pressures, may represent one of our better opportunities for doing just this.

Looking back over this past year, it is apparent that monetary policy has been such as to add substantially to public liquidity, and it may well be that history will accord that policy some credit for warding off a more deflationary

> turn in business. I could wish our policy had been more smoothly and more evenly expansive in its influence, but it is easier to see that with the benefit of hindsight than it was at the time. However, I believe we should learn from this experience and not subtract from the salutary influence of our current policy by wavering in its application. Particularly at this juncture, steady pursuit of a moderately stimulative policy is to be desired. It could assist in reinvigorating domestic economic growth while our gold stock and our improving competitive position internationally are still more than sufficient to sustain the dollar as a world currency.
>
> In my judgment, these considerations mean that we should maintain free reserves in the weeks ahead as high as the average for the past three weeks. Furthermore, the Desk should endeavor to offset any persisting tightness in the money market that might develop as a result of the heavy seasonal pressures likely between now and the next meeting of this Committee.

Mr. Shepardson said he had no comments to add to those that had already been made with respect to the domestic economic situation. He was not as optimistic as some others appeared to be with regard to the international balance of payments situation. As he saw it, the available information did not provide a basis for encouragement, and certain recent developments gave him particular cause for concern. The trade bill that had been enacted was designed to facilitate foreign trade, but certain reports and comments he had seen in the press recently did not appear conducive to satisfactory negotiations, or to working in the direction of improving the foreign trade picture. While he realized that this was an area beyond the purview of Federal Reserve policy, the developments to which he had referred did not portend significant improvement in the balance of payments.

As to policy, Mr. Shepardson indicated that he agreed with the proposal made by Mr. Hayes. He also said that he would favor modifying the policy directive.

Mr. King expressed himself as being slightly more optimistic than three weeks ago. However, this optimism was tempered by the feeling that part of the current increase in domestic activity probably reflected Holiday spending, and he guessed that this spending might in turn be undergirded by the psychology resulting from the Cuban episode. Accordingly, it might be largely of a transitional nature. About the end of January it might be possible to make a more realistic reading of the fundamental strength of the economy.

Mr. Mitchell expressed agreement with the view that there were some disquieting aspects in the present situation. The Cuban crisis was an exogenous factor that had introduced something completely new in the area of expectations with regard to the domestic situation, and perhaps also the foreign trade picture. It was a force that might be described as roughly equivalent to a small tax cut as far as the domestic situation was concerned. Perhaps the effect had already largely worn off, but it might have more endurance than one would suppose. As to the balance of payments, the basic problem was still present. Many people seemed to be coming to a realization that the problem was a great deal more intractable than they had at first thought. The obvious remedies having already been applied, there now seemed to be a tendency toward relying on foreigners to do something or to hope that the natural

course of events would in some way be helpful. This basic problem was one that the Open Market Committee could not do a great deal about, except to take such actions as would lend encouragement to its solution.

Mr. Mitchell went on to say that the Cuban situation and the anticipation of a tax cut seemed to have been instrumental in producing a booming stock market, which in turn had given rise to more rosy expectations than he believed sober consideration would justify. While the situation was better on the face of things, he was not sure that was the case if one looked deeply enough.

Mr. Mitchell commented that he was puzzled about the recent performance of the money supply. To date he had not heard a satisfactory explanation of its behavior. The Committee's directive specified as an objective the encouragement of a further increase in the money supply, and the Committee had been working at it. While it was not clear what had happened, it was a fact that a significant rise in the money supply had occurred. The answer might involve the matter of seasonal adjustment. In any event, however, it seemed clear that it was not easy to bring about a continuing rise in the money supply in the present kind of environment. If the Committee wanted to accomplish this objective, apparently it would have to follow a more aggressive policy of monetary ease. In his view, one contribution that monetary policy could make in the current environment would be to keep long-term rates from rising until there was a period of seasonal weakness, at which time such rates should move down a bit.

Mr. Mitchell suggested that the stock market had perhaps over-discounted the possibility of a tax cut. This was a hazard, for such a cut was not assured. Even less could one foresee the nature of a tax cut, its size, or the economic impact. The Committee should not fall into a similar trap by trying to offset the psychology that had been engendered by an expectation that might not be realized.

In conclusion, Mr. Mitchell said that in terms of policy his views were close to those expressed by Mr. Mills and Mr. Robertson.

Mr. Fulton reported that in the main the rate of business activity in the Fourth District appeared to be stepping up, although some instances of intermittent backsliding also were seen. In a sense, the current movement represented a recovery from previous setbacks. In any event, however, business sentiment appeared to be more optimistic. Although the available statistics as yet did not measure up to the improved sentiment, construction activity appeared to have increased more in the District than nationally. Department store sales had picked up, and retailers were looking forward to an excellent Christmas season, with appliances going well. The unemployment picture had improved somewhat.

The rate of steel production had been improving, largely as a result of buying by the automobile companies, which were now having to buy for current production because their inventories were fairly well drawn down. The auto industry was quite optimistic about a continuation of good sales through the rest of this model year. In light of some

indication that the steel labor contract might be reopened next summer, some of the users of steel might begin to stockpile in the first quarter. There is usually a decline of about 6 per cent in the first quarter, but the steel industry expected production to continue at about the present level, with part of the production going into stockpiling.

The machine tool industry had been heartened by the volume of new orders. Some businessmen and bankers now felt that the tax credit was becoming more of a factor in buying plans and projections for the coming year than had at first been thought. It was now believed that manufacturers would be encouraged to replace machinery and improve their processes. There seemed to be a sound basis for thinking that this would develop into actual orders later in the year.

Turning to policy, Mr. Fulton said he came out at approximately the same point as Messrs. Hayes and Ellis. The good degree of liquidity of both corporations and individuals afforded evidence that monetary policy had made available purchasing power that, when activated, could provide strong economic growth. In view of the degree of ease that had been maintained over a protracted period, it seemed appropriate to him to shift now to a somewhat lesser degree of ease. He felt that free reserves of around $300-$350 million would be more appropriate than $450 million. He would not favor changing the discount rate at this time, but a slight change in the directive to eliminate the reference to the emergency situation seemed appropriate.

Mr. Bopp said there was nothing of significance to report from the Third District. Just as he was not particularly excited about the turn of events nationally, he found nothing particularly exciting in business and banking at the local level.

Mr. Bopp went on to say that he would continue policy essentially unchanged for the next two weeks. He continued to believe that greater ease could be helpful in further stimulating the domestic economy. He was not convinced that recent more favorable statistics and more optimistic sentiment really changed the important fact that the economy was operating at less than optimum levels and was likely to continue in this unsatisfactory state. Given the recent changes in public psychology, however, it was questionable whether overt moves toward more ease could be explained convincingly to the public.

In recommending a continuation of present policy, Mr. Bopp said, he would like to see a continuation of those efforts to provide ease that had a minimum balance of payments and psychological impacts. He would avoid downward pressure on short-term rates and would make no change in the discount rate. He would favor continued open market operations in longer term issues. As to the directive, he would renew it, with deletion of the sentence referring to the international emergency situation. The directive, on this occasion, also should refer to operations during the next two, rather than three weeks.

Mr. Bryan reported a marked change of sentiment in the Sixth District, which seemed to be supported to some extent by available statistics. While there had been small offsetting changes in nonfarm and manufacturing employment, there had also been a considerable increase in average hours worked. There had been a sharp rise in personal income, and a good behavior in the District in terms of bank loans and other financial aspects.

Mr. Bryan said that he would favor no change in policy at this time because he did not see that the current slight upward movement in the economy was assured of growing into boom proportions. He thought that System policy had been good, and in the absence of factors clearly suggesting a boom he saw no reason for a change in policy at the moment. In fact, if he were compelled to make a choice, it would be for a move along the lines indicated by Mr. Mills rather than a drift toward a lesser degree of ease. As he saw it, the economy had the natural resources at the present time to grow at a considerably faster rate than it was now growing. While he did not know what rate of growth would be supportable without inflation, he believed that a 3 per cent growth rate would be tolerable without pressing on available resources of men and material. Accordingly, he would advocate that the Committee continue to provide reserves for seasonal purposes and in addition provide for a small growth factor. He would not want to burden the Account Manager with an instruction in terms of either total or free reserves at this particular time.

Mr. Shuford reported that during October and the first part of November activity in the Eighth District continued at about the level of summer and early fall. It could be said that the District economy was operating at a high level without appreciable or significant changes. Total employment in the major labor markets remained at about the level that had prevailed since May. Business loans at weekly reporting banks could be said on balance to have been unchanged since midsummer. Actually they had increased somewhat for the District as a whole, but business loans in Memphis declined in November as the result of commodity dealers reducing inventories in anticipation of a price-support decline. Total deposits had risen at an annual rate of 7 per cent since May, and bank debits had continued to rise moderately. Looking at the economy as a whole, it would be difficult to say with any degree of certainty that there had been any significant improvement from the high-level plateau that had prevailed through the summer and early fall.

As to policy, Mr. Shuford noted that since August bank reserves and the money supply had increased rather significantly. He was not able to put his finger on exactly why this had happened. Despite monetary expansion, however, the three-month bill rate had remained above 2-3/4 per cent, and more recently was above 2.8 per cent. He recognized, of course, that this reflected largely seasonal credit demands and the increased supply of bills by the Treasury. In view of

the continuing large unused capacity and the lack of upward pressure on prices, it was his view that the Committee should continue the policy that had been followed during the past three weeks, particularly since the Committee would be meeting again in two weeks. He was pleased with what had happened during the past period and would like to see these conditions continue. In terms of free reserves, he would suggest something in the neighborhood of $400-$450 million.

Mr. Balderston said he started in his thinking with the premise that an international balance of payments crisis might be getting closer. That premise seemed to him to provide the focal point for the thinking of the Committee now and in the near future. It was based on the fact that the effort to move toward a basic balance of payments had not been successful during the current year. In fact, if adjustment was made for advance debt repayments to the United States, the figures appeared slightly worse this year than a year ago. This would be a shock when it was understood by the financial world. Moreover, this unhappy result had occurred despite the fact that this country's largest customers abroad had been enjoying good business. Also, as a result of the failure to make progress toward international equilibrium, the willingness of foreign central banks to hold dollars might diminish. The Federal Reserve System could not, of course, control foreign spending and lending or keep costs from rising. However, the problem of keeping costs from rising as fast as those in other industrialized nations

was one with which the System could assist, even if monetary policy was only one of the forces at work. And the System would be at fault if excessive liquidity were to cause funds to flow abroad more heavily.

Mr. Balderston then turned to a more immediate problem that he thought would cause the Committee concern after the December 18 meeting. That problem involved how to hold short-term rates as high as they had been. According to the results of certain calculations made for the Treasury a year ago, bill rates might be expected to fall under some seasonal pressure for several months following Christmas. The pattern suggested that if market forces were left to their own devices, bill rates might fall as much as two-thirds of a point due to seasonal influences.

Mr. Balderston noted that the $450 million average of free reserves for November was the highest in many months. Also, from the low point reached in August the money supply had been rising at an annual rate of 5.8 per cent, and reserves behind private deposits at a rate of 7.5 per cent. This led to the question whether the Committee should delay reducing the level of free reserves until the next meeting or whether some reduction should occur at once. In his belief, the Committee should maintain about the present state of affairs during the seasonal peak of the next two weeks. His principal concern was that before the December 18 meeting the members of the Committee should contemplate how to offset subsequent bill rate pressures that might

develop. Specifically, he felt that he would favor at that time a decisive reduction in the level of free reserves. A supplemental weapon would be a change in Regulation Q to raise the permissible interest rate ceiling on time deposits with maturities from 90 days to six months, in order that such rates might be more competitive with bill rates. If pressure on bill rates should come chiefly from nonbank demand, such a move might help to offset slightly the forces tending to push bill rates down.

In conclusion, Mr. Balderston said he would leave the policy directive unchanged except for the omission of the last sentence of the first paragraph, which had reference to the emergency situation incident to the Cuban crisis.

Chairman Martin began his comments by discussing the problem involved in deriving a consensus on the appropriate course of monetary policy from the varying shades of opinion expressed by members of the Committee. He indicated that he had serious doubt concerning the value of a series of close votes on the precise degree of ease that should be sought.

Turning for a moment to an expression of his own views, the Chairman commented that he continued to believe that the balance of payments problem was not separable from the domestic economic problem. In his opinion, if the Committee had erred, it had erred on the side of trying to do too much to stimulate the domestic economy and not

giving sufficient weight to the balance of payments, for he believed that the latter problem was the largest shadow over the domestic business situation at the present time.

Chairman Martin continued by saying that in essence all of the members of the Committee were for easy money today. Although varying shades of opinion had been expressed, no one was talking about tight money. In his view, the danger of speculation was very real in light of the current availability of funds. Therefore, if he were formulating policy on his own, he would be moving in the direction of slightly less ease. He had expressed this position at the November 13 meeting, and his view had not changed. As he saw it, there had been no significant change of conditions in the intervening period except for the change in business sentiment that had been mentioned so frequently during today's meeting.

The Chairman repeated that the views expressed at this meeting were directed to easy money or slightly less easy money. A poll apparently would result in a slight majority in favor of one or the other of those positions. The majority of the views expressed were close enough together, though, so that in his opinion the sensible course would be to combine them into a position of no change in policy for the next two weeks. Of course, if anyone felt his position was far enough from that point, he could be recorded in the negative.

As he had said, Chairman Martin noted, his personal preference would be to move in the direction of slightly less ease, but he did not think this was sufficiently important, in terms of the forthcoming two-week interval, to put such a relatively slight shading of opinion to a vote. While it might be that his conviction was not well founded, he failed to see how the Committee could make a judgment on the basis of slight variations in the degree of ease when, for example, it was talking about a level of free reserves that no one could really pin-point. To a considerable extent, the Committee must rely on the good judgment of the Account Manager, who in his (the Chairman's) opinion had been performing extremely well recently under difficult conditions.

The Chairman then suggested that a poll be taken on no change in policy and no change in the directive except for the elimination of the last sentence of the first paragraph, which stated that it was the Committee's policy to cushion such unsettlement in money markets as might stem from international developments of an emergency or near emergency character.

Mr. Hayes questioned whether no change in policy was an appropriate expression of the consensus. As he had followed the discussion around the table, it appeared to him that the majority sentiment favored at least a very slight drift in the direction of less ease or, to put it another way, an erring on the side of less ease. He added that what he was talking about here was something that would not go as far as he

himself would like, but he did feel that a slight erring on the side of less ease was probably the majority position.

Chairman Martin replied that the point he had been trying to make earlier, and which he thought Mr. Hayes' comments highlighted, related to the difficulty in drawing a line between, for example, a slight drift in the direction of less ease and a shift to the extent Mr. Hayes would prefer. He was not quite sure how best to approach shadings of that kind.

Mr. Mitchell then suggested that a poll be taken on no change in policy so that it could be seen what that produced.

In reply to a question as to what base should be used in deciding for or against no change in policy, Chairman Martin expressed the view that it was not appropriate to use as a base the conditions that currently prevailed as the result of operations since the preceding meeting. For instance, the level of free reserves that had developed might please one member and displease another member, but the Manager may not necessarily have been trying to achieve any particular level. Instead, the Manager may have been doing the best he could to produce the general degree of ease that seemed appropriate within the framework of the policy expressed by the Committee. When mention was made of no change in policy, the Chairman felt that that should mean no change in the policy that the Committee had previously agreed upon.

Mr. Mills commented that he would be more inclined to look at policy in terms of results. For instance, the decision at the November 13 meeting had been to make no change in policy. However, the results since that meeting represented a definite change, in his opinion a change for the better.

Chairman Martin replied that Mr. Mills was certainly entitled to that view with respect to the results of operations since the last meeting. Others, of course, might have a different view. His only point, the Chairman said, was that he did not think the Account Manager ought to be criticized when he had proceeded in accord with what he understood to be the policy judgment of the Committee.

Mr. Mills commented that it had not been the intent of his previous remarks to criticize the Account Manager, who did his best to carry out the intent of the Committee and work within the terms of the directive. However, there were times when market circumstances would alter the results that the Manager's actions had sought to achieve.

The Chairman then remarked that he would not want to proceed on an assumption that the Account Manager was being asked to make no change in a policy that conformed to a concept of how satisfactory the policy previously agreed upon by the Committee had worked out. What he had had in mind earlier was to obtain the Committee's views on whether to make no change in the policy that the Committee had

agreed upon at the preceding meeting. He then proposed again that the Committee members express themselves on making no change in the policy that reflected the prevailing position of the Committee at the November 13 meeting. This would imply no change in the directive except for the elimination of the last sentence of the first paragraph.

Mr. King inquired whether it was the understanding that the last sentence of the first paragraph of the directive referred specifically to the crisis presented by the Cuban situation, as contrasted with an international balance of payments crisis, and the comments in reply brought out that this was the context within which the sentence was originally included in the directive. It was noted that the last clause of the preceding sentence called for avoiding money market conditions unduly favorable to capital outflows internationally.

Chairman Martin then suggested that the members of the Committee be polled as to whether they would favor any change from the policy agreed upon at the meeting on November 13, 1962, and five members (Messrs. Hayes, Ellis, Fulton, Mills, and Shepardson) indicated that they would favor a change in position, while seven (Messrs. Martin, Balderston, Bryan, Deming, King, Mitchell, and Robertson) indicated that they would favor continuing the same policy as that approved on November 13. Mr. Mills stated that his position favoring a change represented his view that there should be a continuation of the policy of the preceding meeting as reflected by the results of open market

operations since November 13. Messrs. Hayes, Ellis, Fulton, and Shepardson stated that they favored a shift in the direction of less ease than was contemplated by the policy adopted on November 13.

There followed further consideration of the directive to the Federal Reserve Bank of New York in light of the consensus that had just been established, and it was agreed that the directive should be presented for action by the Committee in a form which, aside from a technical change to recognize that there would be only a two-week (rather than a three-week) interval before the next meeting, would involve no change from the directive approved at the November 13 meeting except for the elimination of the last sentence of the first paragraph.

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

In view of the recent stability of economic activity, with a margin of underutilized resources and an absence of inflationary pressures, it is the current policy of the Federal Open Market Committee to encourage moderate further increase in bank credit and the money supply, while avoiding money market conditions unduly favorable to capital outflows internationally.

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

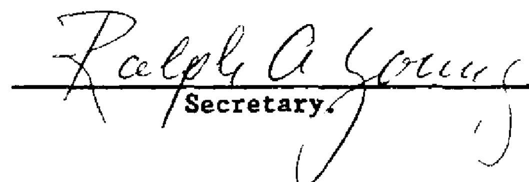
Votes for this action: Messrs. Martin, Balderston, Bryan, Deming, Ellis, Fulton, King, Mills, Mitchell, Robertson, and Shepardson. Vote against this action: Mr. Hayes.

Mr. Hayes stated that his vote against the wording of the directive in the foregoing form was on the same grounds as his vote against the directive approved at the meeting on November 13, 1962, namely, he felt that the wording of the directive gave too little attention to the difficult international balance of payments situation and that it placed its main emphasis on the domestic situation.

It was agreed that the next meeting of the Open Market Committee would be held on Tuesday, December 18, 1962.

In this connection, Chairman Martin noted that it was contemplated that an afternoon session would be held on December 18, at which time there would be discussion of the formulation of the Committee's current economic policy directives. He suggested that in the interim the members of the Committee also give some thought to the problem involved in reaching decisions on monetary policy when the opinions on the objectives that should be sought differed in terms of degree.

The meeting then adjourned.



Secretary.