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, January 29, 1963, at 9:30 a.m.

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

Messrs. Bopp, 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, Garvy, Holland, Koch, and Parsons, Associate Economists
Mr. Stone, 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

Mr. Helmer, First Vice President, Federal Reserve Bank of Chicago
Messrs. Sanford, Eastburn, Ratchford, Baughman, Jones, Tow, and Green, Vice Presidents of the Federal Reserve Banks of New York, Philadelphia, Richmond, Chicago, St. Louis, Kansas City, and Dallas, respectively
Mr. Lynn, Assistant Vice President, Federal Reserve Bank of San Francisco
Mr. Eisenmenger, Acting Director of Research, Federal Reserve Bank of Boston
Mr. Cooper, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Mann, Economist, Federal Reserve Bank of Cleveland

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 18, 1962, were approved.

The staff economic review at this meeting was in the form of a visual-auditory presentation, for which Messrs. Garfield, Altmann, Axilrod, and Reynolds of the Board's staff joined the meeting.

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

> The record for 1962, domestic and international, is now largely at hand--subject of course to revision. In considering the record, one problem that has already emerged is the seemingly divergent figures for the amount of advance actually achieved. Averaging the four quarters of each of the past two years together, GNP measured in current dollars was up 7 per cent from 1961 to 1962. But if one compares the fourth quarter of 1962 with the fourth quarter of 1961, the rate is only 4 per cent. While 1962 was a year of little change in prices, there was some upcreep, especially in the cost of services. If one adjusts for these price changes, the two figures decline to 5 and 3 per cent, respectively. And, of course, the population continued to grow, so that if one thinks of advance in terms of per capita GNP still another slice of the gain melts away, and we find ourselves with an improvement during 1962 of only

1 per cent in the real GNP per capita. It is relatively easy for anyone to find a perfectly good, honest figure that permits him to view the year with satisfaction, complacency, or concern. But it is worth noting that this is true largely because 1962 was a year of moderate advance following a period of rapid recovery.

The second half of 1962 was a period of unusually little change, especially for industrial production, nonagricultural employment, and unemployment. Industrial prices continued to move within a very narrow range, as they had since early 1959.

Despite little change in industrial activity and corporate profits in the second half, common stock prices advanced and now, with a further rise in January, they are two-thirds of the way back to their December 1961 high. In markets for funds, although the forces of demand and supply were so evenly balanced that interest rates changed little in 1962 as a whole, the volume of bank loans and mortgages rose sharply.

There followed sections on the current domestic demand situation by Mr. Garfield, financial developments by Mr. Axilrod, balance of payments problems by Mr. Reynolds, and resource utilization, productivity, costs, and prices by Mr. Altmann. The text of the concluding portion of the review, presented by Mr. Koch, was as follows:

The President's new tax cut proposal, taken by itself, would increase the deficit regardless of the budget concept used. When completed in 1965, the proposed three-stage tax program would likely reduce revenues by an estimated $10 billion or so a year, the bulk of which would be in individual taxes. In considering the appropriateness of this tax cut under current conditions, it should be borne in mind that time and a growing economy tend automatically to raise revenues at current tax rates, and that current tax rates would likely produce a sizable budget surplus under conditions of reasonable full employment if current levels of Government spending did not increase.

The part of the tax cut to be realized in fiscal 1964 would in itself likely reduce revenues by over $5 billion. This would be offset to a considerable extent in its effects on the cash budget by a proposed speed-up in corporate tax payments as well as by anticipated increased revenues arising out of higher income levels. The net loss in revenues in fiscal 1964 is thus estimated at something like $2-3/4 billion. This loss in revenue, together with other elements influencing the cash budget, would entail a rise in the cash deficit from a projected $8-1/4 billion in the current fiscal year to about $10-1/4 billion in fiscal 1964.

In the first half of the current calendar year the budget document projects a small cash surplus, but in the second half the deficit would be quite large since it would reflect not only the first stages of the new tax program but also the usual seasonal imbalance of receipts and expenditures.

The surplus in the first half of this year would be accompanied by somewhat larger net debt repayments if the Treasury draws down its current relatively high cash balances. In the second half of the year, assuming little change in the cash balance, net cash borrowing would no doubt be considerably larger than the $6.2 billion in the last half of calendar 1962 and might well exceed the postwar record of $9.2 billion in the last half of 1961.

What are the implications for monetary policy of an enlarged deficit? This depends very much on the impact that the new fiscal program would have on economic developments. If there is a significant stimulative impact, we can expect enlarged credit demands from the private as well as the public sector, and consequent upward pressures on interest rates, even though financial savings are also likely to increase. How rapidly bank reserves should expand under those circumstances cannot be readily foretold for it depends on general economic conditions at the time, including the strength of private demands and developments in the balance of payments. It also depends on the lagged effects of the substantial bank credit and monetary expansion that has occurred in the last four months.

One's over-all assessment of recent monetary policy must, as always, depend on his fundamental concept of the workings of the financial system. If he believes that for support of maximum sustainable growth in economic activity it is necessary, in the financial area, for the money supply to increase consistently in relation to the advance in activity, then he might well be satisfied with the financial performance of recent months. In fact, in the light of the recent rapid monetary expansion, he might feel that its pace ought to be tempered somewhat.

As another point of view, one's emphasis might be on interest rates and credit availability and their relation to the present state of economic activity. Accordingly, he might feel that monetary policy should operate to keep interest rates, particularly longer-term rates, under sustained downward pressure and to make bank credit even more readily available until progress toward reasonably full utilization of resources is more clearly assured.

Finally, one who feels that our persistent international payments imbalance has the danger of precipitating a dollar crisis in world markets may well emphasize the need for higher interest rates and reduced bank credit availability in order to curb significantly the outflow of funds abroad. He might also feel that the domestic economy is strong enough to absorb, and function satisfactorily under, conditions of less monetary ease.

As for current prospects, the indicators are mixed. Those that measure output and demand are not performing in a fashion that suggests any gathering upsurge in activity. On balance, the outlook seems to be for continued moderate expansion--with caution dictated by the fact that some of the strong elements in the economy that have sustained activity thus far, for example, autos and housing, are not likely to show any further increases in the near-term future.

Key financial indicators, in contrast, are showing a strength that on occasion in the past has foreshadowed a pick-up in underlying economic activity. Recent heavy credit expansion, of course, may be serving mainly to keep the economy from actually turning down. As for the stimulative effects of any tax cut, these are not likely to appear for many months and the magnitude then is uncertain. The over-all balance of payments progress has been below earlier optimistic hopes, partly because of the heavy longer term capital outflow. Very recently, payments disequilibrium has shown a fresh deterioration that thus far cannot be fully explained.

These are the economic facts upon which current monetary policy must be based. Although there are differences of view on the staff as to the most appropriate policy for the near future, generally speaking it is felt that from the standpoint of domestic considerations a stimulative policy posture continues to be appropriate. At the same time, the staff recognizes that continuing adverse balance of payments developments are a matter of grave concern and that these developments work as a constraint on pursuit of a monetary policy course shaped solely to the needs of the domestic economy.

> Thus, there does not appear to us anything in the developments of the last three weeks which dictates that a change in policy in either direction is urgent. This view is underlined by the heavy Treasury financing schedule in prospect. Since maintenance of an even keel in money markets during this period is to be desired, any significant change in policy at this meeting would present difficult problems.

Copies of the script of the economic presentation and of the accompanying charts have been placed in the files of the Open Market Committee.

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 January 8 through January 23, 1963, together with a supplementary report covering the period January 24 through January 28, 1963. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Sanford noted that the exchange markets had in general been relatively quiet since the previous meeting of the Committee, although the pound sterling and Canadian dollar markets were at times quite active. Sterling had shown strength early in the period, but this normal seasonal strength was subsequently offset by the difficulties encountered with regard to British entry into the European Common Market. In the first part of the period the Bank of England acquired dollars in the process of moderating the rise in the sterling rate, but since then the British had lost dollars. The covered interest arbitrage differential moved from a position in favor of British Treasury bills to a slight differential in favor of U. S. Treasury bills. At no stage, however, was there any particular incentive to move funds into or out of U. S. bills. Money, though, was continuing to move to London for the acquisition of hire-purchase paper, and to Canada for the purchase of finance and commercial paper. Also, loans by U. S. banks to foreign banks and acceptance credits continued to be reported in sizable volume. Foreign borrowers continued to tap the U. S. market with new issues, and more such borrowing was scheduled for the future.

The Canadian dollar eased off in the early days of the past period, apparently reflecting market response to a speech by an opposition spokesman in which concern was expressed about the long-run success of the Government's economic program, as well as the Canadian interest and dividend payments to nonresidents customary at this time of year. Subsequently, the market for Canadian dollars firmed considerably, although the rate was still somewhat below the December high. The more recent advance in the Canadian dollar rate was associated with reports of large impending Canadian long-term financing in the United States.

Mr. Sanford also noted that the Swiss franc and Dutch guilder rates had shown little net change for the past three-week period, while the French franc and the Italian lira hovered close to or at their upper limits. The German mark, after showing a considerable decline from its year-end peak, had moved irregularly higher from the level reached in early January.

The price of gold in the London market had fluctuated remarkably little. In general the market had been quiet, and on January 10 the price of gold dropped to the lowest point since December 1959. The announcement in early January of a series of new Indian controls on the buying, selling, and holding of gold had apparently dampened demand in the market. The gold pool had accumulated a moderately large quantity of gold during January.

Turning to System foreign currency operations during the past three-week period, Mr. Sanford noted that on January 15 the Federal Reserve drew $25 million equivalent of sterling under its standby swap with the Bank of England in anticipation of seasonal strength of sterling and a possible need for System intervention in the market. On January 25 the Bank of England offered $5.6 million, which the System took up out of its drawing under the swap, at a rate slightly better than the rate at which the pounds were acquired in the swap drawing.

With regard to negotiations with the Bank of England about the possibility of enlarging the swap agreement between the Federal Reserve and that institution to perhaps $250 million, as discussed at the Committee meeting on January 8, Mr. Sanford reported that the matter was being actively considered by the Bark of England. However, the present situation with regard to the Common Market had injected a factor that undoubtedly was being taken into account in the Bank's thinking.

Mr. Sanford commented that the swap arrangement with the National Bank of Belgium had been an example of use of a swap on a two-way basis. In the middle of the month the Belgians, apparently anticipating dollar needs, redeemed $5 million of the $50 million Treasury certificate of indebtedness that they held by virtue of the Federal Reserve drawing of an equivalent amount of Belgian francs in June 1962. Yesterday, however, the Belgians developed some surplus dollars, and for value January 31 were reconstituting their Treasury certificate investment. In addition, they were selling the Federal Reserve $5 million against Belgian francs held abroad.

On January 17, Mr. Sanford noted, the Federal Reserve System and the Bank of Sweden entered into a $50 million three-month standby swap the negotiation of which was authorized by the Open Market Committee at the meeting on December 4, 1962. On January 17, also, the standby swap between the Federal Reserve and the German Federal Bank was increased from $50 million to $150 million, as authorized at the Committee meeting on January 8, 1963. Pursuant to another authorization at that meeting, on January 18 the Federal Reserve renewed for three months each the $100 million swap arrangements with the Swiss National

Bank and the Bank for International Settlements. It also renewed the outstanding drawings under those swaps in the amounts of $50 million and $35 million, respectively. In addition, pursuant to a further authorization given at the January 8 meeting, on January 18 the Federal Reserve renewed for three months the $150 million swap arrangement with the Bank of Italy. On January 21 the System purchased a total of $50 million equivalent of lire and immediately applied the lire to the repayment of the $50 million drawing under the swap with the Bank of Italy. The swap, therefore, was now fully on a standby basis.

Continuing, Mr. Sanford said that on January 24 the System purchased $50 million equivalent of Austrian schillings from the Austrian National Bank and used the proceeds to pay off the maturing drawing of $50 million under the swap arrangement with the National Bank. Thus, the swap arrangement shifted to a standby basis, and it was renewed for three months on that basis. The National Bank of Austria had now indicated that it wished to buy $50 million of gold over the period of approximately the next four months.

In response to a question by Mr. Mills about disposition of gold in the gold pool, Mr. Sanford commented that in December there had been an accumulation which in January was distributed among the participants. This month there would be a further accumulation, and in February there would probably be another distribution among the members of the pool. Mr. Mills recalled that at the January 8 Committee meeting it was stated that the U. S. Treasury had relinquished its interest in the gold previously redistributed. He inquired as to the current intent of the Treasury. In reply, Mr. Sanford and Chairman Martin stated that this matter was presently under consideration by the Treasury, which had not yet made a decision.

Mr. Mills inquired what amount of System swap drawings had in effect been funded by the Treasury. Mr. Sanford replied that the repayment of the $50 million drawing under the Italian swap had been made possible by a reversal of the previous flow of funds into Italy, and had coincided with an issue of U. S. Treasury securities associated with Italian financing of military purchases in the United States but even in this case there could not be said to have been direct Treasury funding of System swap drawings and to his knowledge there were no other Treasury fundings of swap drawings.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period January 8 through January 28, 1963, were approved, ratified, and confirmed.

It was noted that on January 17, 1963, the New York Reserve Bank advised that pursuant to action of the Open Market Committee on December 4, 1962, authorizing negotiations for a currency swap arrangement with the Bank of Sweden, such an arrangement had been concluded for public announcement. Accordingly, Mr. Sherman, Assistant Secretary, notified the Committee members by telegram on that date that the

Committee's continuing authority directive on System foreign currency operations was amended by adding Swedish kronor to the list of currencies that the Federal Reserve Bank of New York was authorized and directed to purchase and sell through spot transactions in accordance with the Guidelines on System Foreign Currency Operations issued by the Federal Open Market Committee on February 13, 1962, and amended on November 13, 1962. As revised, the continuing authority directive read as follows:

> The Federal Reserve Bank of New York is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the Guidelines on System Foreign Currency Operations issued by the Federal Open Market Committee on February 13, 1962, and amended November 13, 1962:
>
> Pounds sterling
> French francs
> German marks
> Italian lire
> Netherlands guilders
> Swiss francs
> Belgian francs
> Canadian dollars
> Austrian schillings
> Swedish kronor
>
> Total foreign currencies held at any one time shall not exceed $1.3 billion.

Upon motion duly made and seconded, and by unanimous vote, the action taken in sending the aforementioned telegram was ratified.

Mr. Sanford then presented certain recommendations for the Committee's consideration.

First, he pointed out that the swap arrangements with the German Federal Bank and the Bank of France in the amounts of $150 million and $50 million, respectively, would mature February 4, 1963. He recommended their renewal on a standby basis for a further three months.

> Without objection, renewal of the swap agreements with the German Federal Bank and the Bank of France, as recommended by Mr. Sanford, was authorized.

Second, Mr. Sanford recommended that the Committee authorize the sale, when timely and appropriate, of German marks now held in System Account to the Treasury for its Stabilization Fund at a price not less than the average price of acquisition by the Federal Reserve System. He pointed out that at present the System held $27 million equivalent of marks out of a total of $32 million acquired from the Stabilization Fund in February 1962. Provided the mark rate firmed a bit further from its present level--which was about 24.98 cents against an average acquisition price of slightly over 25 cents--he believed it would be desirable to sell a block of these marks--just how much he could not say at the moment--to the Treasury. The Treasury could then use those marks in making swaps with the Bank for International Settlements for the purpose of acquiring Swiss francs, which were needed to meet obligations in the Swiss currency; or at least it would have the marks as cover against its Swiss franc obligations.

In discussion, Mr. Mitchell suggested that the Open Market Committee should not be bound by profit and loss considerations in a matter of this kind. If the Treasury believed it could work out of the Swiss situation by utilizing German marks, he would feel that the System should be prepared to make the marks available to the Treasury, irrespective of whether the mark rate moved up or not.

There was indication of concurrence in this view.

> Accordingly, authorization was given to sell to the Treasury quantities of German marks out of the System's present holdings of $27 million equivalent if such marks should be desired by the Treasury.

The meeting of the Committee then recessed in order that the members of the Board of Governors and the Reserve Bank Presidents might meet with the members of the House Banking and Currency Committee pursuant to arrangements made at the request of the Chairman of that Committee. The meeting reconvened at 12:20 p.m. with the same attendance.

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 January 8 through January 23, 1963, and a supplementary report covering the period January 24 through January 28, 1963. Copies of both reports have been placed in the files of the Committee.

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

The highlight of the bond market since the last meeting was the Treasury's sale on January 8 of $250 million long-term bonds at competitive bidding by underwriting syndicates. The thirty-year bonds were awarded to the winning group at an interest cost of a shade over 4 per cent and were publicly reoffered to investors at par to yield 4 per cent. The issue was quickly oversubscribed and rose to a premium in the market that same afternoon. This accomplishment was highly gratifying, both in terms of the keen competition generated among the bidders and the rapid distribution of the securities to investors. Most market participants were much impressed by the results and are prepared for further trials of the technique, under varying circumstances, as the Treasury seeks to determine its usefulness as an additional means of marketing long-term obligations.

Stimulated by the success of the auction, Treasury bond prices generally rose during the first part of the three-week period and the new 4 per cent bonds temporarily reached a bid quotation of almost 100-3/8. Around mid-January, however, a more cautious attitude pervaded the market under the influence of the President's tax and budget messages and the news that a continuing erosion of the gold stock might be expected to occur in early 1963 because of the persisting balance of payments deficit. Prices edged lower and most intermediate and long-term issues were down 2/32 to 22/32 for the period, with the new 4 per cent bonds closing last night at 100-2/32 bid.

The invigorating atmosphere produced by the Treasury's successful bond auction also carried over into the markets for corporate and municipal bonds. Bidding for new issues was fairly aggressive and a new Aa-rated corporate utility issue was reoffered to investors on January 15 at a yield of 4.20 per cent, the lowest yield on a comparable issue since mid-1958. Investors offered some resistance to the lower rate levels, however, and during the latter half of the month the corporate and municipal sectors, responding to the same developments that affected the Treasury bond market, became rather hesitant. Moreover, there have been several sizable new issues scheduled for the months ahead, although the immediate calendar of forthcoming offerings is not particularly heavy.

In the short-term market, rates on Treasury bills fluctuated narrowly over the period, closing the interval very close to those prevailing at the start despite the fact that they typically undergo some seasonal downward movement during the early weeks of the year. In yesterday's auction the three-month bills were sold at an average rate of 2.92 per cent--the same as the average established in the auction three weeks ago. This relative stability of bill rates was the outcome of opposite forces of roughly equal strength. Tending to push rates lower was a generally good demand which, although it was not always vigorous enough to meet the market's hopes and expectations, was sufficient to reduce dealer bill positions noticeably. Offsetting the downward influence on rates exerted by this demand, however, was an addition of $500 million to the roll-over of the January 15 bills and the announcement of a new issue of $1 billion June tax anticipation bills to be sold at auction tomorrow, with commercial banks not permitted to pay for the bills through credits to tax and loan accounts. In addition, the short-term market, in company with the longer term sector, evidenced renewed concern over the balance of payments and the budgetary outlook.

The availability of reserves since the last meeting turned out to be somewhat greater than in the preceding three-week period, owing in good part to the erratic behavior of float, which rose unusually high and stayed up unusually long. The money market nevertheless remained generally firm, and Federal funds traded at 3 per cent most of the time. Meanwhile, the expansion in seasonally adjusted total and required reserves continued.

In closing I should note that the Treasury financing calendar will be full between now and the next meeting of the Committee. I have already mentioned the prospective sale of $1 billion June tax bills tomorrow. And later this week the Treasury will announce the terms under which it will refund its $9.5 billion February 15 maturities, of which $5.5 billion are publicly held.

In discussion based on Mr. Stone's comments, Mr. Swan referred to the seasonal downward pressure on Treasury bill rates in the early weeks of the calendar year. He had noticed that a year ago such downward pressure appeared practically to have terminated by about the end of January. He inquired whether that would appear also to be true this year.

Mr. Stone replied that he thought the seasonal downward pressure did tend to terminate by about the end of January. Although a precise dating was difficult, the downward pressure tended to ease off after the first couple of weeks of the calendar year.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities during the period January 8 through January 28, 1963, were approved, ratified, and confirmed.

Under date of January 24, 1963, there had been distributed to the Committee a memorandum from Mr. Stone and Mr. Farrell, Director of the Board's Division of Bank Operations, suggesting a revision in procedures for allocation of participations in the System Open Market Account. The memorandum noted that when the present formula was adopted on March 6, 1962, it was pointed out that although the new procedure for reallocating participations at quarterly intervals (February, May, August, November) would tend more nearly to equalize gold reserve ratios (against notes and deposits combined) of the various Reserve Banks, occasional adjustments might still be necessary if, because of temporary conditions, a Bank's ratio should fall below 30 per cent just before a Federal Reserve weekly statement date or a month-end date. It was also noted that further deterioration in the combined reserve ratios of the twelve Banks might make it desirable to reduce the 30 per cent guidepost specified in the procedures. This point was mentioned again by the Account Manager at the Committee meeting on September 12, 1962. Reserve ratios had in fact continued to decline; on one day in December the ratio for all Banks combined reached as low as 31.4 per cent. Individual banks had had ratios below 30 per cent on a number of Tuesdays and days preceding monthends; on Monday, January 14, one Reserve Bank had a ratio of only 25.7 per cent, the lowest in recent history. Since the adoption of the current plan last March, there had been 21 reallocations, 11 since the last regular quarterly reallocation on November 1, 1962. Some of the special reallocations could not be quickly reversed since the ratios of the Banks concerned remained relatively low for extended periods. The reserve ratio situation was most acute over the year end. Since then, there had been some improvement, but individual Banks continued to experience low ratios and special reallocations continued to be necessary. With the gold stock undergoing further erosion, it seemed likely that rather frequent special reallocations might still be necessary despite the seasonal drop in note and deposit liabilities. When that seasonal decline came to an end in the spring, the making of special reallocations could become virtually a continuous process.

In order to reduce to a practicable minimum the number of special reallocations, it was proposed that sections 2 and 3 of the current procedures be amended by substituting 28 per cent wherever 30 per cent appeared in those sections. It was felt that such action would reduce, and for a few months perhaps eliminate, special reallocating of the Account. If 28 per cent had been in effect since the new procedures were adopted last March, no special reallocation would have been required. Setting the figure at 28 per cent should not, at least for the next few months, preclude any Bank from having leeway to avoid a situation in which its ratio fell below 25 per cent on a statement date, although this possibility could not be entirely dismissed no matter what procedures were used for allocating participations in the Account. It was recommended that the foregoing proposal be adopted by the Open Market Committee.

In supplementation of the distributed memorandum, Mr. Stone commented as follows:

> The proposal to reduce from 30 per cent to 28 per cent the reserve ratio that must be reached before a special reallocation of the Account is undertaken grew out of the series of 21 such reallocations that were made as a consequence of the further deterioration in reserve ratios over the past few months. As note and deposit liabilities expand with the growth of the economy, and with the gold stock continuing to decline, there is every likelihood that as the year goes on the technical accounting problems connected with low reserve ratios will become more pressing. Moreover, we recently experienced a different kind of problem in that two of the Reserve Banks, on separate occasions, found themselves with virtually all of their participations in the System Account pledged against Federal Reserve notes. On one of those occasions, I should note, the reserve ratio of the Bank concerned was very close to 25 per cent, and in reallocating the Account to raise that Bank's reserve ratio we found there were not enough unpledged securities to enable us to put the ratio up to the System average. This kind of problem may also recur. As the Committee knows, both the approach to the problem of reallocating the Account and the plan for pledging Reserve Bank participations against Federal Reserve notes were evolved at a time when the problems I have just described were regarded only as remote possibilities. Those problems, however, are now with us, and hence it seems appropriate to take a fresh look at the entire gamut of procedures involving the reallocation of the Account and the pledging of participations against Federal Reserve notes.

> Accordingly, we have constituted, in the New York Bank, a three-man group to take a close look at these procedures and to determine whether they are fully adequate to the present circumstances in which reserve ratios are pushing toward 25 per cent and in which a Reserve Bank's participation in the Account is barely adequate to cover its note issue. I understand that a similar group is being constituted within the Board staff, and we anticipate that the two groups, working cooperatively, will have some conclusions to lay before the Committee and the Reserve Banks within the next few weeks. Given the statutory requirements governing reserve ratios and the pledging of collateral behind the note issue, it may well turn out that present procedures, with a patch here and there, are about as good as can be devised. But we think it is worthwhile to make the study before jumping to the conclusion that this is so.

In discussion of the matter, Mr. Ellis endorsed the proposed change from 30 per cent to 28 per cent. He went on to point out, however, that the amended procedures would provide that if a Bank's reserve ratio should be reduced below 28 per cent as a result of a reallocation, or should fall below 28 per cent on the next to last business day (as observed by the Agent Bank) of a statement week or month, its holdings as of the close of business that day would be adjusted the following day by an amount sufficient to raise its reserve ratio to the average reserve ratio of the twelve Banks combined on the preceding day; and that any such adjustment would be reversed on the first succeeding Thursday (before the next quarterly reallocation) when it could be accomplished without reducing the Bank's reserve ratio below 28 per cent. It was the suggestion of Mr. Ellis that the rigidity of the language providing for reversal of any such adjustment be relaxed somewhat. If it appeared that a reversal was going to force a Bank below 30 per cent, and lead to another adjustment the following week, he felt it would be helpful if the reversal could be postponed at the discretion of the Manager of the Open Market Account. This seemed particularly true during a period when, as Mr. Stone had stated, a comprehensive staff study was being made of existing procedures.

There was unanimous agreement that the proposed procedures should be amended in a manner reflecting the suggestion of Mr. Ellis.

> Accordingly, upon motion duly made and seconded, and by unanimous vote, the procedures with respect to allocations of the System Open Market Account, as approved by the Open Market Committee on March 6, 1962, were amended to read as follows:

1. Securities in the System Open Market Account shall be reallocated on the first business day of February, May, August, and November of each year by means of adjustments proportionate to the adjustments that would have been required to equalize the average ratios of the 12 Reserve Banks over the first 85 days of the preceding three calendar months.
2. If a Bank's reserve ratio should be reduced below 28 per cent as a result of the reallocation, or should fall below 28 per cent on the next to the last business day (as observed by the Agent Bank) of a statement week or month, its holdings as of the close of business that day shall be adjusted the following day by an amount sufficient to raise its reserve ratio to the average reserve ratio of the 12 Banks combined on the preceding day. Such securities shall be allocated to the Bank in a position to absorb the largest additional amount without reducing its reserve ratio below the ratio of the 12 Banks combined. If that Bank is unable to take the entire amount, the excess shall be allocated to the Bank which can absorb the next largest amount without reducing its reserve ratio below the average for the System.

   Any such adjustment will be reversed, at the discretion of the Manager of the System Open Market Account and the

Bank, on the first succeeding Thursday or thereafter (before the next quarterly reallocation) when it appears that it can be accomplished without reducing the Bank's reserve ratio below 28 per cent, except that if the Thursday is a holiday or the last business day of a month the reversal will be made the following business day. A reversal will restore individual Bank holdings to their established participation percentages before the adjustment occurred, except to the extent that a Bank may have been involved in another adjustment in the interim.

3. If a Bank's reserve ratio should fall below 28 per cent on any other day, or if a Bank anticipates that its reserve ratio will fall below that figure, it may arrange with the Manager of the System Open Market Account for an adjustment similar to those provided for in paragraph No. 2 so as to increase the Bank's reserve ratio to the average of the 12 Banks combined.

4. The Account shall be apportioned during the succeeding quarter on the basis of the ratios determined in Paragraph 1, after allowing for any adjustments as provided for in Paragraphs 2 and 3.

5. Profits and losses on the sale of securities from the Account shall be allocated on the day of delivery of the securities sold on the basis of each Bank's current holdings at the opening of business on that day.

Mr. Hexter, Assistant General Counsel, joined the meeting during the discussion of the foregoing topic and withdrew at its conclusion.

The Chairman then called for the usual go-around of comments and views on current economic developments and monetary policy. He turned first to Mr. Hayes, who presented the following statement:

As we compare the latest available statistics with those of three weeks ago, or six weeks ago, we find that the domestic business situation remains virtually unchanged, whereas there has been further clear deterioration in our balance of international payments and, potentially at least, in the status of the dollar.

Retail sales are exhibiting considerable strength so far in January, and consumer confidence appears high. However, the cautious appraisal of the Council of Economic Advisers, with which most business economists seem to concur, suggests no likelihood of any great upsurge in 1963; and the attainment of a significant drop in unemployment still appears decidedly remote.

Business sentiment continues to be strong, even though recent weeks have not produced any tangible evidence of the emergence of additional factors of strength. With the details of the President's tax reduction and reform proposals now on the table, in the coming weeks the business community and the public at large will try to appraise the chances and the actual timetable of their enactment.

As for the balance of payments, unusually large capital outflows, both long and short term, seem to have been mainly responsible for a sharp rise in the over-all deficit to something over half a billion dollars so far in January. Also it is now apparent that very sizable loans and acceptance credits to foreign banks explain why the December surplus was only $80 million despite about $400 million of receipts from special transactions. The sale of some $150 million of new Canadian securities in our capital market in January, together with the $97 million Chrysler purchase of Simca shares, serve as a dramatic reminder of the major contribution of long-term capital outflows to our balance of payments problem, while the placing of some $75 million of new U. S. dollar time deposits in Canadian banks emphasizes the continuing inability of U. S. banks to compete on even terms with Canadian and European banks in attracting and holding dollar balances. Additional large new foreign bond issues are in prospect for the coming months. Despite the fact that the gold and exchange markets remain generally calm, we face a large loss of gold in the first half of 1963 even on the basis of existing orders alone. Further sizable losses could easily occur as a result of the weight of existing heavy dollar balances, without taking into account the effect of additional future payments deficits. Moreover, there is an ever-present danger of serious loss of confidence as the size of our monetary gold stock shrinks further and approaches the $15 billion level.

Under these conditions, I find especially disturbing an apparent tendency in some Government circles to accept continuing large payments deficits as inevitable. It is also discouraging to note the considerable shrinkage in our export surplus in the last quarter of 1962. Although the immediate export outlook seems moderately cheerful, at least if we consider our exports to Japan and Canada, there is an ominous note in the growing evidence of the nation's apparent inability to hold the line effectively on wage costs at a time when this is of greater importance than ever. In the recent dock strike settlement, for instance, there seemed to be, on the surface at least, little or no stress on the general aim, so widely publicized a year ago, of trying to keep wage increases within the limits of gains in national productivity.

As has been true now for several months, recent data on bank credit raise a question whether we have not been perhaps excessively liberal in providing reserves to the banking system. I am thinking of the fact that total credit at weekly reporting banks declined in the first three weeks of January much less than is typical for this season. Thus, in effect, the strong bank credit upsurge of the last few months of 1962 has continued. The dollar rise in bank credit in December, and indeed for the fourth quarter as a whole, as well as for the full year 1962, was the largest for any similar period on record. After a sluggish performance during most of 1962, the money supply came to life in the last quarter and rose again sharply in the first half of January. Required reserves against private deposits have been running some $300 million above the 3 per cent guideline.

Of course the imminence of the Treasury's refunding program sets severe limits on our freedom of action in the monetary sphere for the next two weeks. But I should think the least we should do is to maintain the increased firmness of market atmosphere decided upon at the two last meetings.

The directive might appropriately be modified to give recognition to the forthcoming Treasury financing, the further deterioration this month in the balance of payments situation, and the fact that policy will apply to a two-week period; but I would think that otherwise the directive could be left unchanged.

While no overt move, such as a discount rate increase, can be undertaken during this period of Treasury financing, I think the Committee would do well to be thinking a little further ahead concerning the appropriate role of monetary policy in the light of the increasingly serious threat to the dollar's international standing. As you know, I have long favored a change of policy mix, with increasing reliance on fiscal policy to provide the needed stimulus to the domestic economy, while monetary policy would thereby achieve greater scope to help meet our international responsibilities. While there is some question whether the proposed tax reductions will in fact provide the hoped-for incentive effects, and the proposals are obviously far from final enactment, the question can be fairly raised whether the Administration has not already gone a long way toward a change of mix as far as fiscal policy is concerned. Certainly several years of heavy budget deficits are now widely expected both in this country and by foreign observers. Would it be unreasonable to suggest that monetary policy consider in the fairly near future a positive step of its own toward a new "mix"? Such a step in itself might well hasten effective tax reduction, first, as a demonstration that fiscal measures rather than continuing monetary ease must be looked to as a means of stimulating more rapid economic growth; second, by convincing those who are inclined to fear tax reduction as "irresponsible" that the monetary authorities intend to see that the prospective deficits are prudently financed.

As I have said, these are matters for future determination; but perhaps it is none too soon to explore them, if only in the most tentative and preliminary fashion. In the meantime, it seems to me that there is one technical area in which the Board could be helpful at any time in the near future without interfering with our "even keel" policy. I refer to the desirability of raising the maximum permissible interest rate payable on 90-day time deposits to remedy the present inability of the American banks to quote reasonably competitive rates for maturities under six months.

Mr. Shuford said that observations made at the past several Committee meetings concerning the Eighth District continued to hold true. There had been no significant changes in economic activity. Employment in St. Louis and in each branch city had declined slightly since July 1962, while industrial use of electric power showed no appreciable change. Business loans outstanding at weekly reporting banks fluctuated within a narrow range, and bank debits had increased only slightly. Department store sales showed some improvement during the past four months, which improvement apparently was continuing in January. Total deposits of weekly reporting member banks increased markedly in 1962, and this trend continued in the first part of January, with the increase again in the time and savings deposit category.

Mr. Shuford commented that the national economic picture had been covered well by the staff presentation this morning and also by Mr. Hayes. As Mr. Shuford saw it, there was no clear trend, developments appearing to be mixed. Since last August, however, total bank reserves had risen at an annual rate of 7 per cent, reserves available in support of private demand deposits had increased at an annual rate of 5 per cent, and the money supply had increased at an annual rate of 7 per cent. While he regarded the growth in these areas as having been desirable in the past few months, continued growth at such rates--certainly for any appreciable period of time--would appear to be undesirable. In view of the recent increase in reserves and the money supply, coupled with the expansion of bank credit, he believed that monetary operations such as conducted during the past six weeks continued to be appropriate. This seemed particularly true in view of the forthcoming Treasury financing. In short, he would continue existing policy. He saw no need to change the directive, although it might be modified along the lines mentioned by Mr. Hayes. He would not consider it appropriate to change the discount rate at this time.

Mr. Bryan commented as follows:

> The biggest news from the Sixth District has been the unseasonably cold weather. The freezes have lowered the outlook for citrus production by an estimated 25 per cent. Vegetable production will probably match the production of last year except for tomatoes. The longer run damage to citrus production cannot yet be reliably estimated because damage to the trees will not be known for some time. In the meantime, citrus prices have gone up sharply, and total income from the crop may be largely unaffected.

The Sixth District has followed the national pattern in the consumer, agricultural, and banking sectors. It has shown somewhat more weakness than the nation in employment and production. District employment in December declined appreciably for the first time in 1962 as did the length of the work week and manufacturing payrolls. Insured unemployment was slightly lower in December; but it was still higher than at any time since February 1962. Bank credit has risen further in December, and seems to have receded less than seasonally in January. The expansion of bank credit in 1962 has been much greater than in 1961. All in all, the Sixth District, like the nation as a whole, seems to me to be going nowhere in a great rush, but to be making a slow, steady upward movement with little evidence of a downward turn in the business cycle.

As for monetary policy, it seems to me that we have made a satisfactory year-to-year gain in terms of money supply conventionally defined. If all or, indeed, some part of time deposits are included in our estimate of money supply, then I judge the year-to-year increase in the money supply to be not only satisfactory but stimulative. Further, liquid assets held by the public as a ratio to the gross national product have risen to 80.8 per cent, the highest since the 81.0 per cent of third quarter 1959.

Meanwhile, the reserves of the banking system, whether measured in terms of total reserves, nonborrowed reserves, or required reserves, have been running higher than my judgment of an appropriate guideline. The long-term trend line that I have from time to time used was for January a little less than $19.6 billion. On a daily average basis, up to my most recent figure, our actual reserves in January have run at $20.17 billion, a substantial excess over a 3 per cent growth rate. At the same time, we have exceeded the projections of the Board's staff, both on total reserves and required reserves. In the light of these circumstances, I believe we should at least move downward in actual reserves to something more nearly like the 3 per cent guideline.

Since we are going into February with a large oversupply of reserves, according to the latest figures available to me, and face a large seasonal in February, approximating $450 million, I believe the Desk is approaching an unusually difficult period. It is made the more difficult in view of prospective Treasury financing. The central target on total reserves for February, using, for all its distempers, a total reserve trend line that I have from time to time sponsored--albeit with some misgivings--is $19.6 billion for February.

> In the light of the factors as they appear to me, I should suggest that figure as a rational central target for total reserves on a daily average basis. Of course, the Desk must have an ample latitude for random factors. It remains for me to note that the figure I suggest reconciles with a much lower daily average of free reserves than we have had thus far in January.
>
> I would not change the discount rate.

Mr. Bopp reported that business in the Third District deteriorated somewhat in December. Unemployment claims declined, but only seasonally; help wanted indexes were off in Philadelphia; electric power consumption by manufacturers dropped; and manufacturing employment decreased in 6 of 10 reporting areas. Available weekly information for January showed no exceptional movements.

In banking, the picture was mixed. Loans had been declining, largely for seasonal reasons, but this year's drop was about 50 per cent greater than last year. Deposits are off, and reserve positions had reflected some tightness.

Mr. Bopp saw no reason for any change in monetary policy at this time, particularly in view of the Treasury financing schedule. As to the directive, he felt that it might be appropriate to delete the reference to "seasonal" downward pressures on short-term interest rates.

Mr. Bopp also commented that within the past week or so he had received a call from an official of a large local bank that was considering the possibility of entering into foreign lending to take advantage of interest rate differentials. The banker inquired whether such activity would be against public policy or Federal Reserve policy, particularly since representatives of the bank who had talked with European central bankers got the impression from some of them that perhaps some day central banks might have to do something about such decisions. Mr. Bopp said his comments to the banker were to the effect that such lending would obviously have repercussions on the U. S. balance of payments, which was already in a serious state. At this time, however, there were in this country no specific laws or regulations to control such matters. He did not propose to make a decision for the banker, although the latter might want to keep in mind the problem that existed with regard to the international balance of payments.

Mr. Fulton reported a slight to moderate expansion of business and industrial activity in the Fourth District during the first three weeks of January, representing in part a short-term pick-up from weather-retarded activity in December and in part a continuation of longer-term recovery from 1962 setbacks. During the past week, however, intense cold and more snow had halted this betterment.

Steel output showed significant improvement during the first three weeks of January but suffered a modest relapse in the past week, probably due to weather conditions. New orders were showing strength, One mill dealing largely with the auto industry showed substantially increased orders, with lead times extending to April. Another mill not so dependent on autos reported a good order book from a wide variety of users. While there seemed to be no pronounced indication of inventory accumulation, the situation could be interpreted as heralding an end to inventory liquidation, with orders representing needs for current production.

There was no opinion presently as to whether or not the steel wage contract would be reopened on May 1; the union could make a demand for reconsideration of wages, insurance, and pensions on that date. It was said that a better atmosphere existed between management and labor at this time due to the efforts of the Human Relations Committee (composed of top men from management and labor), which had been effective in interpreting mutual problems, but one could not foretell what might develop. Steel executives were saying that it was imperative that there be no increase in employment costs this year. Otherwise, steel would be at a greater disadvantage competitively. Steel workers now cost $4.30 per hour, including fringe benefits.

In the machine tool industry, there was a general feeling that if the level of manufacturing was maintained the industry could count on an increase in orders of 10 to 12 per cent in 1963 over 1962. New machines were being developed that would radically reduce production costs, which should encourage manufacturers to invest in them.

Insured unemployment in the District remained above the national average, ranging from 10.5 per cent in Pittsburgh to 3.5 per cent in Dayton, with a District average of 6.9 per cent. Centers of high unemployment were predominantly in steel manufacturing areas. In the first three weeks of January, increases were approximately in line with the seasonal pattern, but the past week of severe winter cold and snow had disturbed this relationship.

Department store sales continued at the expanded level of late 1962. In the four weeks to January 19, sales were 9 per cent over the year-ago period. Auto sales remained at a relatively high level, after allowance for seasonal decline, even through the latest week of bad weather. Used car sales suffered from the weather, but prices remained firm and sales were expected to rebound. Construction permits were substantially reduced from the same period last year. In Cleveland, apartment house building was still strong and accounted for 40 per cent of the construction volume in that city in the first three weeks of 1963.

Loans at District reporting member banks declined more in the past three weeks than in any like period of the past three years. Bank debits for the District for December remained virtually unchanged from November.

Mr. Fulton said he could discern nothing on the economic horizon that would warrant a change from the monetary policy now being followed. He felt that the Desk had ably followed the instructions of the Committee during the past three weeks. He would not change the discount rate, feeling that an increase in the rate would be a measure that might be regarded as slanted toward deflation. In this connection, he noted that mention had not been made of the effect, which could not yet be assessed, of the increases in rates of employer-employee contributions to the Social Security System that became effective at the first of the year. This would take more money away from pay envelopes and therefore would have a deflationary bias. As to the directive, he would eliminate from the second sentence of the first paragraph the references to economic and financial factors relating to 1962.

The meeting then recessed for lunch and reconvened at 2:05 p.m. with the same attendance.

Continuing the go-around, Mr. Mitchell said that in view of the imminence of Treasury financing any remarks on short-run monetary policy at this time would seem largely academic. As to the business outlook, he recalled having mentioned at the Committee meeting six weeks ago that he sensed some stirrings in the economy, largely of psychological origin, that might possibly lead to a rise in real activity at a greater rate than had recently been experienced. He had thought at the time that such a possibility was rather remote. However, subsequent developments suggested to him that the likelihood was increasing. In his opinion the developments to which he referred really began to take shape about the time of the relief from the Cuban crisis, a truly exogenous factor. It may also have been attributable in some degree to the reduction of reserve requirements against time and savings deposits, a move that he had thought at the time should be construed as an easing action. Anticipation of a tax cut was another factor. In sum, there had been a change in the economic environment. The stock market picture had changed, there had been a reaction in consumer spending, and consumer attitudes had changed. Although the staff economic presentation today seemed to indicate that not much was happening in real terms, he felt that much had been happening in psychological terms and perhaps in real terms also, particularly in the area of consumer demand. Business demand for plant and inventories admittedly was not strong, but this might appear later in light of developments such as he thought were now taking place. It was his feeling that there was a tendency to downgrade the likelihood of an upturn in activity at significantly greater rates than in 1962. This was one reason for sitting tight in terms of monetary policy.

Mr. Mitchell then referred to the change in money supply and in reserves that had occurred over the past several months. He detected a tendency to act as though this was an accomplishment of which to be proud, yet he believed that actually the Committee did not anticipate what would happen. In his opinion it happened because the economy had reacted to exogenous factors, primarily psychological. The kind of monetary policy pursued was conducive to monetary expansion under these changed conditions, and it had occurred. In any event, he believed the business outlook was better than it had been for a long time and that monetary factors were better than they had been for a long time. Accordingly, he would be content to maintain the status quo in terms of policy.

Mr. Shepardson remarked that it seemed rather odd that the discussion of the national economy had proceeded thus far without more pointed reference to the dampening effects of the severe winter weather that had prevailed in many areas of the country. Of itself, this might have accounted for some of the slowdown observed in certain segments of the economy. Nevertheless, as Mr. Mitchell had said, things did not look too bad. This, together with the Treasury financing program, would argue for a continuance of the policy that had been in effect during the past three or six weeks.

Mr. Shepardson said that he had not had in mind, particularly, suggesting a change in the directive. However, his attention was drawn during the discussion to a phrase that had been creating a question on his part for some time. Especially in view of the terms of the recent dock strike settlement, he was inclined to question the reference to an absence of inflationary pressures. In terms of prices that statement might still have validity, even though there had been a consistent upward crawl in consumer prices. According to reports, however, the terms of the dock strike settlement were excessive, and this appeared to him a definite indication of a building up of inflationary pressures that at some point might break out in more noticeable fashion. Such pressures may have been less pronounced than at other times, but he did not agree that there was an absence of them.

In summary, Mr. Shepardson said, he would continue present policy. If there was a change in the directive, he would hope that consideration might be given to modifying the reference to an absence of inflationary pressures.

Mr. Robertson said it seemed obvious that in view of the impending Treasury refunding offer there was no option today except to maintain an even keel position in the absence of overriding considerations, none of which were apparent in the business and financial information presented to the Committee this morning. The position from which the Committee would be moving was much better than he had thought it would be on the basis of the directives adopted at the previous two meetings of the Committee. Events had belied a progressively tighter policy such as he had thought would eventuate under those directives. If it seemed important, he would be agreeable to changing the directive along lines such as suggested by Mr. Fulton. However, he did not think such changes were too important, assuming that the consensus of the Committee would be to maintain an even keel and make no change in policy at the moment.

Mr. Mills presented the following statement:

> Broadly speaking, the experience gained in 1962 seems to indicate that the over-all expansion that occurred in commercial bank credit was financed out of a massive increase

in time and savings deposits that, in turn, was supported by reserves supplied by Federal Reserve System actions. The System also provided reserves in addition to those required to backstop the increase in time and savings deposits, but in doing so without inducing a further and economically constructive expansion in commercial bank credit of the kind normally associated with a vigorous growth in the national economy. In the presence of a sluggish economy and in the absence of a dynamic demand for commercial bank credit, the additional increments of reserves at the disposal of the commercial banking system failed to serve any useful purpose and, in fact, were harmful by encouraging an abnormal growth in loans on the collateral of U. S. Government securities and in fostering speculative inventorying on the part of U. S. Government securities dealers.

Under these circumstances, and there being no foreseeable increase in the legitimate demand for commercial bank credit, it is in order to reduce the volume of free reserves to a level in keeping with the visible demand for commercial bank credit, say, $350-$300 million. The fact that such a policy would tend to hold up short-term interest rates as a deterrent to the outflow of United States dollars and gold must be considered as a secondary effect of a monetary and credit policy that seeks to keep an appropriate balance between the supply of reserves and the legitimate demand for commercial bank credit. Inasmuch as a continuing and compounding reduction in the supply of reserves inevitably would contract the credit base, with damage to the money supply, extreme caution must be exercised in bringing down the level of free reserves to be certain that only those reserves are withdrawn that are demonstrably superfluous to the legitimate credit needs of the national economy and, therefore, that adequate credit availability is maintained.

Mr. Mills added that he believed the present stance of the Committee in the conduct of monetary policy was in line with the reasoning he had expressed, and that no change was required. He did not think that the discount rate should be raised at this time, but he continued of the belief that if a crisis should materialize out of balance of payments problems it would be necessary to take prompt and dramatic action, with joint determination, decision, and action by the System and the Treasury.

Mr. Wayne reported that recent business developments in the Fifth District had occurred mainly within usual seasonal patterns. Construction, trade, services--in fact all nonmanufacturing areas except mining--had apparently retained recent strength. Manufacturing activity, however, had continued the very gradual declines in employment and man-hours that first appeared last August. The Reserve Bank's latest survey indicated slight further declines in new orders, employment, and hours in textiles and in durable goods industries except furniture. In nondurables other than textiles the survey showed new orders, employment, and hours virtually unchanged. Furniture manufacturers in the survey indicated that their already prosperous industry was still moving ahead, and the winter markets in progress last week at furniture centers in North Carolina and Virginia were reported to have generated the largest volume of forward buying in many marketing seasons. District banks had experienced a substantial drop in gross loans, particularly in the business classification, while real estate loans continued to gain. In the first and final weeks of the period, District banks were heavy net sellers of Federal funds.

Mr. Wayne commented that he found himself at a loss to say much new or exciting about the national situation. Such important indicators as manufacturing wages and salaries, nonagricultural employment, and industrial production had remained virtually constant since July. At the two preceding Committee meetings a flurry of good signs suggested that the economy could be moving off its plateau. The strength in retail sales in January also pointed in this direction. On the other hand, some of the old uncertainties reappeared in December. Housing starts fell, new orders for durable goods dropped, the average workweek shortened, and commercial and industrial contract awards slipped badly. A perhaps even darker cloud loomed from the possibility that debate over the proposed budget and tax reforms would be long and acrimonious. Consequently, Mr. Wayne said, he would not be at all surprised if the clear skies everyone had been seeking were not some way off.

In the area of policy, Mr. Wayne believed that System operations--together with some favorable market developments--had been fully successful in combatting the downward pressures on short-term rates that usually prevail during this season. Recently bill rates had been firm with a slight upward trend. The rate for Federal funds had quite consistently been at or near the discount rate, and in the Fifth District a number of sales had been reported at 3-1/8 per cent. These trends had helped to eliminate, or in a few instances even to reverse, the covered spreads favorable to London and Canada on Treasury bills. It seemed to him these results were as much as could reasonably be expected from monetary policy in the international area at this time. Domestically, the healthy growth in bank credit and the money supply in recent months seemed to indicate that the policy the Committee had been following had provided all the funds needed to encourage business expansion. For the next two weeks, with the Treasury in the market, only one course of action--an even keel policy--seemed open. In any event, however, he would favor a continuation of present policy, with perhaps a minor change in the wording of the directive to drop the reference to "seasonal" downward pressures on short-term rates. He would not change the discount rate.

Mr. Clay commented that it would appear appropriate to continue until the next meeting of the Committee essentially the same monetary policy adopted at the last meeting. For one thing, the large Treasury financing activities in the period immediately ahead suggested no change in policy unless circumstances were compelling. Moreover, seasonal financial developments of the early weeks of the year had not proceeded far enough to establish a clear pattern of the basic trend. Additionally, whatever clarification the Committee might have hoped to receive on fiscal matters following the various Presidential messages and Congressional reaction to them as an aid to its own policy deliberations had not yet become apparent--nor was there any indication as to when there would be such clarification. In any event, it was only two weeks until the Committee would meet again and could take another look at the economic situation and monetary policy.

This view on monetary policy for the period immediately ahead, Mr. Clay added, would call for about the same degree of firmness in the money market as was envisaged in the current directive, a Federal funds rate ranging between 2-3/4 and 3 per cent, a Treasury bill rate of 2.85 to 2.95 per cent, and a continuation of the Reserve Bank discount rate at 3 per cent. The directive should be modified, he thought, so as to avoid giving an instruction for a progressive tightening of bank credit on a seasonally adjusted basis.

Mr. Helmer reported that economic activity in the Seventh District continued to display a mild rate of improvement. Businessmen and bankers showed increased confidence that the trend would continue. Production by manufacturing firms in major cities in which electric power series were available reflected modest increases in December. Retail sales apparently continued strong in January, but probably suffered a setback in the most recent week because of the severe cold weather. Auto sales were strong. Production of some makes and lines of cars had been cut back to keep inventories in line with planned levels, but inventories of most new cars were not out of line with sales. Employment showed seasonal changes, but should continue to rise in steel-producing centers where production was rising gradually, partially as a hedge against a possible strike. Capital expenditure plans were being increased in several important industries, and Midwest businessmen were showing greater interest in the new depreciation guidelines.

Banking developments were roughly in line with the rest of the country. Business loans were down relatively less since year end than in the nation. However, the large banks had added to their holdings of short-term Governments and were showing some improvement in basic reserve positions as compared with December averages. The demand for credit was perhaps somewhat stronger than seasonal. The acquisition of short-term Governments and the large volume of loans might indirectly reflect corporate needs for funds. There had been a moderate increase in the number of member banks borrowing in recent weeks, but over all there appeared to be no difficulty in accommodating credit demands.

Mr. Deming noted that mid-winter was not a particularly good time to appraise Ninth District economic performance and prospects. Agriculture, mining, lumbering, construction, and other outdoor activities were at or close to their seasonal lows, which also were reflected in seasonally low employment levels. Add what seemed to be an almost seasonal "first quarter blues" and an abnormally cold January, and the result was a somewhat less exuberant outlook from the Reserve Bank's opinion panel on economic prospects for the next several weeks. The most recent survey, taken as of January 23, indicated that about 46 per cent of respondents saw improvement as fairly certain or probable, 42 per cent looked for stability at present levels, and 12 per cent saw decline likely. The latter group comprised about the same number as in all surveys since early last fall. The big shift in the latest survey was from those who had been forecasting improvement right along into the camp of those who had foreseen stability equally long. It must be noted that industrial power use, manufacturing employment, and personal income at year end were off a shade more than seasonally, although this may have reflected no more than a less than perfect statistical adjustment and/or the cold weather. Still there seemed to be little concrete evidence of any real deterioration in the District economy, and most measures showed District performance as relatively better than the nation. Thus, he attributed a good part, if not most, of the shift in opinion to what he had called the "first quarter blues."

District banking developments continued along the same lines as in recent months and about paralleled developments in the nation's banking. After abstracting from seasonal factors, District banks, both city and country, exhibited continued strong deposit growth and loan demand. Deposit trends remained stronger than loan trends, however, so loan-deposit ratios showed little change. As he had observed before, though, he had a mildly uneasy feeling that the loan-deposit ratios implied a somewhat higher liquidity level than might actually prevail. He thought it necessary to watch this factor with some care.

Turning to the national scene, Mr. Deming noted the absence of exuberance in the economic forecasts for 1963 and the apparently paradoxical behavior of the stock market. He saw prospective stimulation from growing Government spending and a very large deficit both this fiscal year and next. As he analyzed the President's tax program, however, he saw little, if any, stimulation of the private sector from that factor, at least over this year, even assuming that the program was enacted. Finally, he was disturbed by what seemed to be developing in this country's international payments position. It looked to him as though the difference between commercial exports and imports was narrowing and as though efforts to promote commercial exports, to "tie" more of this country's aid, and to offset part of its military expenditures abroad had not even kept the trade balance as large as it was, let alone enlarged it. If this was so, he supposed it was even more important to insure against capital outflow, but he believed the problem of payments balance would need far more than central bank-Treasury holding action re short-term funds.

Mr. Deming recalled having mentioned at the January 8 meeting that the problem mix was not much different from that of a year ago: underutilized capacity and a payments deficit. He was not so sure now that this was an accurate statement; the problem mix might be worse at present. For the immediate future, however, he believed the Committee should continue the present course of monetary policy, which he categorized as ease with an eye on short-term rates. Therefore, he would recommend no change in policy and no change in discount rate during the next two weeks. He supposed that this should mean no more than technical changes in the directive, but the directive's phrasing continued to bother him, particularly the references to money supply and bank credit. These had not moderated in growth rate, and he saw no reason to provide critics with free ammunition by expressing objectives that the Committee might not achieve. He could live with the second paragraph, although he noted that the firm tone in the market referred to by the Manager was expressed in terms of rates and "feel and color" rather than in reserves (either total or free) or in borrowings. He did not imply any criticism of the Desk in this comment; he had been on the daily telephone call during this period and thought the Desk had done very well. At the same time, this did underline his concern about trying to write directives in very specific terms.

Mr. Swan reported increasing concern in the Twelfth District over the lack of rain and particularly the lack of any significant snowpack in the mountains. There had been some damage to the citrus crop, but otherwise the economic situation continued to be favorable in the District. Preliminary data indicated that total employment rose about 4/10 per cent in December, although there was little or no increase in mining, manufacturing, or transportation employment. The seasonally unadjusted unemployment rate in the Pacific Coast states was down slightly in December. Construction activity and retail sales held up well, and department store sales for the first part of January continued strong. For the first time since early 1961 a major labor market area (Spokane) had been reclassified from the moderate to substantial unemployment category.

Weekly reporting banks showed much less than the usual seasonal decline in loans during the first two weeks of January. They were faced at the same time with some deposit decline, and there was some reduction in their holdings of Governments. Also, the banks were net buyers of Federal funds. On at least one day (January 23) a number of the banks were rather heavy borrowers from the Reserve Bank.

With respect to policy, Mr. Swan said he came out at about the same place as most of those who had already spoken. Given the lack of change in the business situation, the fact that the downward seasonal pressure on the bill rate seemed to have been successfully offset, and the imminence of Treasury financing, there seemed nothing to do except continue on even keel. As to the directive, he agreed that at this point the question was again confined to technical changes. However, he would like to see a change made by omitting the reference to "seasonal" downward pressures on bill rates. Also, he continued to be bothered a little by the reference to a current policy of accommodating further, though more moderate, growth in bank credit. He realized that this expression was presumed to refer back to the growth over several months, but he felt that readers of the policy record might interpret the directive as making a comparison with the previous three-week period. It would seem to him a little clearer if the directive referred to "further growth, though more moderate than has occurred in recent months, in bank credit and the money supply." He would not change the discount rate at this time.

Mr. Irons reported a mixture of small pluses and minuses in Eleventh District economic indicators. Several indicators had moved up modestly, including crude oil production. Employment was up about one per cent in the latest period for which figures were available, while unemployment was at a rate of about 4.9 per cent on a seasonally unadjusted basis. Retail trade had been good over the holiday season and into the first three weeks of January.

As to banking, investments were up and there had been a rather substantial increase in time deposits. Loans were down a little less than seasonally, including commercial and industrial loans. District banks had been net purchasers of Federal funds for the past three weeks.

All in all, Mr. Irons said, conditions in the District tended to continue at a high level. The extent of damage to agriculture as the result of the recent series of cold spells was not known, but evidence beginning to seep through indicated that the damage probably was not as bad as at first expected. Construction activity was still at very high levels in and around the major cities.

Mr. Irons said that he saw no need to elaborate on national economic developments. From the standpoint of the economic situation as it was evolving and from the standpoint of the forthcoming Treasury financing, he saw no choice but to continue to maintain the same policy posture as had prevailed over the past six weeks or so. He shared some of the concern voiced by Messrs. Hayes and Deming with respect to what might eventuate in the area of the balance of international payments. He would not recommend changing the discount rate, and he would not change the directive in any basic respect, although he would be agreeable to some of the technical changes that had been suggested.

Mr. Irons suggested that the Federal funds rate should continue around the discount rate level, with the bill rate at 2.90 per cent, plus or minus, and free reserves somewhere from $250 to $350 million. He was not too concerned about where free reserves might move as long as other factors continued about as they had been. If there should be indications of a trend toward more market ease, he felt it would be desirable to take offsetting action.

Mr. Ellis reported that New England economic measures, including employment, unemployment, construction, manufacturing output, and new orders, all built up to a picture indicating that the regional economy was now somewhat weaker than in the late fall, on a seasonally adjusted basis, and relatively weaker than the national economy. However, available measures of consumption seemed to point toward a somewhat more healthy situation. The weakening of business activity was reflected at member banks, where commercial and industrial loans were down more than seasonally in December and on into January. The reaction on the part of the banks was to step up their loans to brokers and dealers and to expand their holdings of Government securities; also, to interrupt their liquidation of other securities, including State and local Government issues.

Mr. Ellis commented that he had been gratified by the continued strength of the short-term rate. This strength was somewhat surprising to him in view of the anticipated seasonal weakening and the relatively large volume of free reserves. Perhaps this suggested that float-generated reserves tended to have a lesser impact on rates than others. In any event, it was clear that the money supply had expanded further and that the level of required reserves against private demand deposits had held substantially above the 3 per cent guideline. Thus it did not appear that the slight shift of monetary policy had interfered with the objective of a continued growth of bank reserves and the money supply. It might be that the growth rate was still too high to be sustainable or desirable. However, at this time of year the underlying trends were so obscured as to prevent obtaining a reliable reading of the impact of policy. The need for an even keel during the Treasury financing led him to recommend no change in policy for the next two weeks. Due to seasonal factors, the Desk would be required to supply perhaps $1/2 billion of reserves during the next few weeks. To contain the effect on the short-term rate, some of these reserves might be released through operations in the medium and longer term areas of the market.

Mr. Ellis said as targets for monetary policy he would think in terms of a bill rate of around 2.90 per cent, perhaps tilted toward 3 per cent, with free reserves around $300 million. He did not feel that discount rate action would be appropriate at this time. In his belief, this kind of policy could be carried out within the terminology of the present policy directive. Yet he understood that the directive was intended to be flexible and to reflect shades of change in the intervals between meetings, and there seemed to him to be at least three places at which changes might be suitable at this time. The first would be to strike the reference to downward "seasonal" pressure on short-term rates; the second would be to refer to the forthcoming two-week, rather than three-week, period. The third involved the question whether the policy of accommodating further, though more moderate, growth in reserves and the money supply should be related to some period of time in the past.

Mr. Balderston described as cogent the reasons that had been advanced during the discussion for maintenance of the status quo. He indicated that he had been impressed by the observations suggesting that possibly severe international payments troubles were closer at hand than one might think. He continued of the opinion that perhaps the Board of Governors should increase the maximum permissible rate on time deposits with maturities from 90 days to 6 months so that the banks could pay, if desired up to 3-1/2 per cent. Funds apparently had been flowing to Canada recently on an uncovered basis, and it seemed none too soon to take such countervailing action as possible. As to the directive, he would be agreeable to the minor changes that had been suggested. Two weeks from now, when the Committee met again, he felt that the directive might need more fundamental modification.

Chairman Martin noted that this was a rather easy meeting to summarize. He would not take time for personal observations except to say that he concurred in Mr. Mills' comments about the international situation and that he thought the remarks of Mr. Bopp about the banker in the Third District were significant. He had felt for a long time that at some point this country was going to be confronted with a crucial international payments problem. He did not pretend to know when this would come to a head, and he might be just seeing ghosts, but he believed the trend was clearly in that direction. At some point, in his opinion, this country would have to come to grips with the problem in a more direct way than had been done to date.

Chairman Martin then remarked that, as at the January 8 meeting, Mr. Young had prepared a draft of economic background statement. He would not ask Mr. Young to read that statement, but it would be included in the minutes so that the Committee members would have an opportunity to review the summary.

Secretary's Note: The draft of economic background statement to which the Chairman referred, as revised in the light of subsequent comment, was as follows:

Information on the domestic economy becoming available since the preceding meeting of the Committee on January 8 indicated a continuation of little change through December in industrial activity, employment, and wholesale prices, but commercial bank lending was showing evidence of stronger credit demands and financial markets were reflecting a more optimistic climate generally. Bank credit and the money supply had expanded considerably over the preceding 3 months, while deposit velocity continued to climb.

The unemployment rate rose in January, but remained within the narrow range of other recent months. Incomplete weekly data for January indicate increases in output of steel but no change in production of autos. The number of housing units started and the volume of new orders received by producers of machinery and other durable goods declined in December from very high levels.

Personal income and retail sales rose further to record levels in December. Partial data for January suggest a further increase in retail sales, with both new cars and department stores showing continuing strength. Consumer prices edged down slightly in December, reflecting mainly seasonal influences. The slowing down in the rate of rise of the service component was again in evidence.

In the financial area, the three major Administration messages--budget, economic, and tax--emphasized fiscal and other efforts to stimulate economic growth, and this emphasis contributed a note of caution to bond markets. Yields on U. S. Government and some other fixed return securities rose a little, on balance, from their levels in early January. Corporate security financing in January was indicated to be considerably smaller than in December while municipal financing was estimated substantially higher. Common stock prices rose further in recent weeks on sizable trading volume and stock prices had now recovered two-thirds of their decline from December 1961 to June 1962.

There was a further sharp rise in the seasonally adjusted money supply in the first half of January, but indications for the second half were for some cutback in the increase. Time deposits also rose substantially further in the first half of the month. Required reserves of member banks against private deposits were averaging somewhat higher during January than in December. Free reserves also were averaging higher, with both excess reserves and borrowing lower. The money market developed a slightly firmer tone after the first week of January, with the 3-month bill rate holding slightly above the 2.90 per cent level at a time when seasonal downward pressures are typically strong.

The U. S. balance of payments position deteriorated in January. Weekly indicators of U. S. monetary reserves and liquid liabilities suggested an over-all deficit for the month of around $500 million. The prolonged dock strike possibly contributed to this deficit and there was a record volume of new foreign security issues in this country in January, largely Canadian issues. Exchange markets remained quiet and the London gold price stayed virtually unchanged near its low point.

Chairman Martin went on to say that he interpreted recent Committee discussions as reflecting a view that the policy directive should focus attention on whether some change in policy was indicated. Minor changes in language might be perfectly appropriate, but attention should focus on whether the Committee was making any change in policy.

The Chairman noted that there had been several suggestions for minor changes in the directive adopted at the meeting on January 8, 1963. He then stated that he would call upon Mr. Young to read a draft of directive that would take account of some of those changes. It was clear, the Chairman pointed out, that no member of the Committee wanted a change in policy at this time. In his opinion, it would be possible to operate satisfactorily during the coming two weeks under the directive as it now stood, without any change at all. On the other hand, he would have no objection to making minor changes. He did feel, however, that the focus ought to be on whether any change in policy was indicated.

Mr. Young then read the draft of proposed directive, with comments on the changes from the present directive.

In discussion of the draft directive, Mr. Mitchell raised the question whether so many minor changes in wording were necessary or desirable when the consensus was clearly for no change in policy. Mr. Young then reviewed the changes and stated why he felt they would be appropriate, after which Chairman Martin called for comments by other members of the Committee. Mr. Hayes indicated that personally he favored changing the directives in minor respects from meeting to meeting, thus preserving the idea that the directive was reasonably flexible, not rigid. Although the consensus for this meeting was for no change in policy, he thought it appropriate to recognize factual changes in the directive. It was true, for example, that the balance of payments position had deteriorated recently.

As the discussion proceeded, Mr. Mitchell referred to the language of the second paragraph of the directive that called for providing for moderate reserve expansion. It was his thought that this kind of language needed some reference point. On the other hand, the view was expressed that any significant amendment to the second paragraph of the directive might be taken to indicate some change in policy, whereas no change was sought by the Committee for the next two weeks. As an alternative, it was suggested that the first sentence of the first paragraph be modified to make clear that the Committee's current policy was to accommodate growth in bank credit and money supply, though more moderate than in recent months. It was also suggested that, consistent with maintenance of the status quo, the last sentence of the second paragraph might call for providing for "continued" moderate reserve expansion.

Mr. Deming expressed the view that if there was no change in policy the Committee should make only minimal changes in the directive. He would regard the changes Mr. Young had suggested as factual or technical corrections with the exception that he thought the wording of the first part of the directive might be interpreted to reflect some shift in policy. In line with the views he had expressed at the two previous Committee meetings, Mr. Deming said his basic point, however, was that he did not like to see the directive set forth, as a current policy of the Committee, an accommodation of growth in the money supply.

Certain additional minor changes in the draft directive were then suggested, following which Mr. Young read the directive in a form intended to reflect the several changes that had been tentatively agreed upon during the discussion.

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

It is the Committee's current policy to accommodate growth in bank credit and the money supply more moderate than in recent months, while aiming at money market conditions that would minimize capital outflows internationally. This policy takes into account the recent deterioration in the United States balance of payments and the recent substantial increases in bank credit, demand deposits, and the reserve base, but at the same time recognizes the limited progress of the domestic economy in recent months, the continuing underutilization of resources, and the absence of inflationary pressures.

To implement this policy, and in view of the forthcoming Treasury financing, System open market operations during the next two weeks shall be conducted with a view to maintaining about the same degree of firmness in the money market that has prevailed in recent weeks and to offsetting downward pressures on short-term interest rates, while providing for continued moderate reserve expansion.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bryan, Deming, Ellis, Fulton, Mills, Mitchell, Robertson, and Shepardson. Votes against this action: none.

Chairman Martin commented that he hoped the members of the Committee would continue to devote thought to the formulation of the policy directives. It was important to try to put them in as good a form as possible because the directives, when published, would provide the core of the record of Committee policy.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, February 12, 1963.

The meeting then adjourned.

Ralph A. Young

Secretary