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, May 7, 1963, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Bopp
Mr. Clay
Mr. Irons
Mr. King
Mr. Mitchell
Mr. Robertson
Mr. Scanlon
Mr. Shepardson

Messrs. Treiber, Hickman, Shuford, and Swan, Alternate Members of the Federal Open Market Committee

Messrs. Ellis, Bryan, and Deming, Presidents of the Federal Reserve Banks of Boston, Atlanta, and Minneapolis, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Baughman, Brill, Eastburn, Furth, Garvy, Green, Holland, Koch, and Tow, Associate Economists
Mr. Stone, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. 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. Heflin, First Vice President, Federal Reserve Bank of Richmond
Messrs. Mann, Ratchford, Rawlings, and Jones, Vice Presidents of the Federal Reserve Banks of Cleveland, Richmond, Atlanta, and St. Louis, respectively
Messrs. Litterer and Lynn, Assistant Vice Presidents of the Federal Reserve Banks of Minneapolis and San Francisco, respectively
Mr. Willis, Economic Adviser, Federal Reserve Bank of Boston
Mr. Cooper, Manager, Securities Department, Federal Reserve Bank of New York

Secretary's Note: Mr. Hickman, who became President of the Federal Reserve Bank of Cleveland on May 1, 1963, following the retirement of Mr. Fulton, executed on the same date his oath of office as Alternate Member of the Federal Open Market Committee.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on March 26 and April 16, 1963, were approved.

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 April 16 through May 1, 1963, together with a supplementary report covering the period May 2 through May 6, 1963. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Coombs reviewed current and prospective developments with respect to the U. S. gold stock and summarized developments in the London gold market, including the results of gold pool operations. He noted that the U. S. dollar had recently been under pressure against a widening group of European currencies.

Discussing the Netherlands guilder situation, Mr. Coombs said that the Federal Reserve had begun to intervene in the market on April 11 in anticipation of an early easing of the tight Netherlands money market and had since sold approximately $15 million equivalent of guilders in the Amsterdam and New York markets. Rather than easing, however, the Netherlands money market had remained tight, and a forthcoming Dutch Government bond issue might add to the pressure. Accordingly, the System was continuing to supply guilders and thus restrain a rise in official dollar holdings of the Netherlands Bank. Had the System operations not taken place, the Netherlands Bank would have already reached the point of converting additional dollar holdings into gold. If the current pressure should continue, it would probably be desirable for the System to draw the remaining $25 million equivalent of guilders available under its swap arrangement with the Netherlands Bank, but at some point it might also be necessary for the U. S. Treasury to come into the picture. The New York Bank hoped shortly, through consultation with a visiting official from the Netherlands Bank, to be able to obtain a clearer understanding of the basic reasons for the inflow of dollars into the Netherlands, including the extent to which the inflow was associated with money market tightness, along with some indication of the possibility of action by the Netherlands Bank to relieve the current market tightness.

Mr. Coombs noted that the foregoing comments outlined the kind of situation that the System was likely to run into from time to time in the future, involving the reaction on the exchange rate of a tightening of money markets in various European countries. He was not entirely sure as to the appropriate role for System swap arrangements in such circumstances, but was inclined to think that there was a good case for using swap arrangements to offset some temporary tightening in money markets abroad.

Mr. Coombs went on to say that the German mark problem was somewhat similar to the guilder situation. The Federal Reserve began intervening in the market on April 9 in anticipation that the inflow of dollars into Germany would be of a temporary nature, selling marks both for its own account and for the account of the Treasury. The inflow had continued, however, despite strike and other developments in Germany that might have been expected to check it. Accordingly, after conversations with the German Federal Bank, the System drew $25 million equivalent of marks yesterday under its swap arrangement with the Bank and subsequently sold $1.8 million equivalent of marks from the proceeds of the drawing. The New York Bank had also given the German Federal Bank authorization to intervene today in Frankfurt on behalf of the System up to $10 million equivalent, and it was expected that the German Federal Bank might supplement this action, if necessary, through use of its own resources. While efforts were continuing to obtain a clearer picture of the reasons for persistent inflow of dollars, it was difficult for both the Germans and ourselves to ascertain precisely why money was moving.

Turning to the Swiss franc, Mr. Coombs said that efforts to pay off the System's Swiss franc drawings had been disappointing. Since February the System had been able to acquire only $27 million equivalent, this during a period of seasonal weakness for the Swiss franc. He felt increasing concern, therefore, that the drawings of Swiss francs might remain outstanding for an unduly lengthy period of time. In this connection, he noted that the U. S. Treasury would shortly be issuing a $23 million bond to the Swiss Confederation to provide an investment outlet for the continuing budget surplus of the Confederation, and the Treasury would utilize the proceeds to repay all but $6.5 million of its outstanding Swiss franc forward contracts. This would reduce the Treasury's cash balance requirements in Swiss francs and it might be possible for the System to purchase $7 or $8 million of Swiss francs from the Treasury, which it could apply against its drawings under the swap arrangement with the Bank for International Settlements. Beyond that, the System could pay off its Swiss franc drawings only to the extent that the market situation permitted the acquisition of francs. If it did not, the System might be up against a troublesome problem. In view of the desirability of limiting swap operations to short-term credit needs, it might be desirable within the near future to pay off the System drawings, in the process placing more dollars in the hands of the Swiss National Bank that would be convertible into gold. The Treasury could then either settle in gold or undertake to issue bonds or certificates denominated in Swiss francs.

As to the pound sterling, Mr. Coombs said its position seemed basically strong; the British had recouped in April part of the reserve losses sustained in the first quarter of this year. Last Friday and yesterday, however, sterling was under some pressure. Apparently, this was not because of speculative maneuvering but instead was attributable principally to some fairly sizable borrowing by Continental commercial banks in the Euro-dollar market. In these circumstances, the Account Management concluded that it would be useful, to purchase for Federal Reserve account a moderate ammount of pounds sterling at the rate of $2.7988. Part of the sterling thus purchased would be placed in a cash account and the remainder in a "money employed" account. There had been some exploration of the possibility of buying commercial bills in London with System sterling holdings, but the prospect was not encouraging due to the limited over-all supply of such bills and the strong demand for them.

In reply to a question, Mr. Coombs also commented on possible effects of the reduction yesterday by the Bank of Canada of its discount rate from 4 per cent to 3-1/2 per cent.

Chairman Martin inquired as to the extent of System transactions with the Treasury Stabilization Fund, and Mr. Coombs recalled that at the start of the program of Federal Reserve foreign currency operations the

System had acquired token amounts of four different currencies from the Stabilization Fund. Later it also purchased some German marks from the Stabilization Fund and then resold German marks to the Fund. All transactions had been at market rates. He hoped that the Committee would not object to the possible purchase of Swiss francs from the Stabilization Fund, as previously suggested, for he considered it important to make further progress in reducing the System's Swiss franc drawings. After further comments by Mr. Coombs on the mechanics of the proposed transaction, Chairman Martin indicated that he would have no objection. He considered it important, however, for the System to keep its records carefully on operations of this kind. Mr. Coombs repeated that all System-Treasury transactions had been at market rates and said there would be no deviation from this rule.

Mr. Balderston suggested that the staff prepare for the Committee a memorandum dealing with the questions involved in the event of continuation of drawings under swap arrangements beyond periods longer than normally associated with the reversal of seasonal or speculative influences, including the mechanics of repaying such drawings. There was general agreement with this suggestion, and Mr. Coombs indicated that such a memorandum would be prepared.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period April 16 through May 6, 1963, were approved, ratified, and confirmed.

Mr. Coombs pointed out that the $50 million swap arrangement with the Bank of England would mature May 28, 1963, and recommended its renewal for another three months.

After discussion, renewal of the swap arrangement, as recommended by Mr. Coombs, was authorized by unanimous vote.

This concluded the discussion of System foreign currency operations.

Before this meeting there had been distributed to the members of the Committee a report covering open market operations in U. S. Government securities and bankers acceptances for the period April 16 through May 1, 1963, and a supplementary report covering the period May 2 through May 6, 1963. Copies of these reports have been placed in the files of the Committee.

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

> The money market has been steadily firm during the period since the last meeting. The Federal funds rate was typically 3 per cent with occasional trading at 2-7/8 per cent and, early in the period, a very temporary softening to around the 2 per cent level. System operations during the period first absorbed and then supplied reserves. The absorption was achieved largely through outright sales of Treasury bills in the market and to foreign accounts. Later, reserves were provided through repurchase agreements and through outright acquisitions of both bills and coupon-bearing issues--the latter being the first purchases of coupon issues in a month.
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> Net reserve availability fluctuated rather widely during the period as the location and intensity of use of reserves responded to various market forces--particularly the heavy Treasury redeposits with the "C" banks starting about the middle of the period and only now beginning to be reversed. As

a result of these redeposits, which tended to funnel an unusually heavy proportion of Treasury cash holdings into the money centers, the money market was if anything slightly more comfortable in the statement week ended May 1 compared with the previous week--even though free reserves were estimated to be about $100 million lower. Starting yesterday the Treasury began to call back some of the $1.3 billion of special redeposits made between April 25 and May 1. As this process continues it may tend to produce a reverse effect on the money market and it may require somewhat higher levels of net reserve availability to maintain a steady tone in the money market.

Treasury bill rates have continued to move in a narrow range during the past three weeks--with the three-month rate remaining between 2.88 and 2.92 per cent and the six-month rate between 2.98 and 3.02 per cent. The average issuing rates in yesterday's auction--about 2.90 and 2.99 per cent for the three- and six-month issues, respectively--were within 1 or 2 basis points of the rates three weeks earlier. This stability has grown out of a rough counter-balancing of opposite forces in the market. On the one hand there has been a continuing good demand from investors (particularly some State funds in the recent period), while on the other hand the Treasury has been enlarging its weekly offerings by $100 million, rounding out the cycle that began in late March. With next Monday's auction, however, the Treasury will reach the end of these $100 million additions to the weekly bill offerings and accordingly the weight may be shifted in the recent balance of forces that has tended to hold bill rates steady.

In the bond markets the atmosphere has improved during the past few days, although it still remains somewhat cautious. The current Treasury refunding has proceeded in a very smooth fashion, with trading activity in the rights and when-issued securities lighter than normal but still quite substantial. The conversion into the reopened 3-5/8 per cent notes of February 1966 somewhat exceeded market expectations, but the larger amount is being taken perfectly well in stride. The $550 million of attrition was a bit more than some observers had expected, but it was certainly not high by past standards. Meanwhile, there has been continuing interest in the distribution of the new $300 million issue of 4-1/8 per cent Treasury bonds of 1989-94 which were still in syndicate at the time of the last meeting. The syndicate marketing these bonds terminated on Friday morning, April 26. Although half of the bonds were still apparently unsold at that time, only a small fraction of the unsold bonds (perhaps $30-$40 million) were placed for immediate disposal These were absorbed by the market at prices of around 100-3/8--or 3/8 point below the syndicate reoffering price, which represented a change of only 2 basis points in yield. Following this initial movement of bonds, trading in the 4-1/8's turned very quiet until the last few days of the period when some moderate buying interest reappeared and dealer quotations edged up a few 32nds. The issue was quoted at 100-15/32 bid, 17/32 offered at the close yesterday, about the level the syndicate paid for them.

In the corporate market better progress has been made in the past few days in distributing some recent slow-moving issues--particularly following the rather aggressive pricing of the $25 million A-rated General Telephone of California issue, which was reoffered to yield 4.39 per cent. While this issue itself moved slowly, it tended to strengthen investor interest in some other recent offerings. Currently the market is focusing attention on today's offering of $250 million Aaa-rated American Telephone and Telegraph bonds designed to refund a 5 per cent issue put out several years ago. A week ago it was expected that this issue might be reoffered in the neighborhood of 4.45 per cent, but with the recent improvement in market tone there is now some feeling that it might go below 4.40 per cent and indeed some of the more ebullient people in the market are talking in terms of 4 35 or 4.36 per cent. If this issue moves out well, it could give a lift to the entire market, possibly stimulating also some greater interest in the Treasury's 4-1/8's

Current Treasury financing plans are highly indefinite because of the uncertainties surrounding the debt limit. We understand that if the current proposals for a $307 billion limit through the end of June are approved by the Congress, the Treasury may seek to borrow about $1 billion in the early part of June--although it will not need the funds until July--in order to make a start on the heavy borrowing that will be necessary to meet the cash needs of the second half of the year.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period April 16 through May 6, 1963, were approved, ratified, and confirmed.

The Chairman then called for the usual staff economic and financial reports, and Mr. Noyes presented the following statement on economic developments:

> The problem this morning seems to be to try to determine whether the dramatic improvement in business sentiment and expectations in the last few weeks has just caught up with, or has overrun, the improvement in economic activity that has actually occurred. The history of this cycle thus far is one of undulating and moderate expansion, upon which rather wide shifts in confidence have been superimposed--up in late '61, down in mid '62, up again in late '62, down in early '63, and now up once more. Certainly recent history would counsel caution in projecting, even a few months into the future, either rapid increases or declines in the pace of expansion. On the other hand, it is obvious that both booms and busts have to start small and build on themselves. Is there anything in the facts available that would help to tell us whether this is the beginning of an upward surge of major proportions, or just another zag in the gentle uptrend that has prevailed for some time?
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> First of all, we can say with some certainty--although the data for the month are fragmentary--that April did not show the same widespread improvement that occurred in March. On the basis of weekly data, we are estimating that seasonally adjusted retail trade was down a little, despite the continued strength in auto sales. In the case of department stores, where we have had more experience in estimating monthly changes from weekly figures, it seems fairly certain that there was a modest drop.
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> The small rise in unemployment is not large enough to be statistically significant, but it is fair to say that there was no further improvement.
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> On the other hand, the production index, boosted by a half point gain attributable to increased steel output, will certainly be up--and may well register a two-point gain over the rounded index of 120 in March. But even this favorable development must be discounted to some extent because it is due in part to inventory building in anticipation of a steel strike.

Also, the more optimistic estimates of capital expenditure plans reported in the McGraw-Hill survey must be qualified to some extent--in that the improvement over the Commerce-SEC survey taken about two months earlier is probably somewhat less than the raw figures would suggest, because of differences in sample design.

These and other qualifications--such as a slight upturn in unemployment compensation claims toward the end of April--argue that it would be premature to assume that the current strong performance of the economy will produce an upward spiral of problem proportions.

But if one thinks in terms of monetary policy, as we must here, there is also little question that the economy is now in a better position, both in terms of basic strength and business psychology, to absorb any negative impact that might flow from a moderately less easy monetary policy. In fact, a shift in the direction of lesser ease may have already been discounted in financial markets, and some of the more optimistic business forecasts that have been widely circulated make explicit mention of the fact that they "allow for" less ready credit availability. Obviously, the mere fact that the economy could probably take a moderately less easy policy in its stride at this point is not in itself a reason to change, and a positive case for change still seems to me to be hard to find in the domestic scene. Sensitive material prices have remained unchanged at below year-ago levels. Further study of the details confirms the generalization reported at the last meeting that the actual effects of the mid-April steel price actions are not large. They amount to about a 1 per cent increase in the BLS index for all steel mill products, which had actually been drifting down since 1958. Whether there will be significant secondary effects from the changes remains to be seen, but the general atmosphere in the markets remains highly competitive.

Our measures are not sufficiently accurate to gauge month-to-month shifts in the relation of output to capacity, but there can be little doubt that the recent advances in production have made up most, if not all, of the widening in the gap that had been occurring since early last fall. Speaking very roughly, as one must with these broad aggregate measures, in terms of the percentage of the labor force employed, the use of our industrial capacity, and prices of goods generally, we are just about where we were a year ago. If these were the only factors to be considered, they would not seem to suggest the need for any action to retard the rate of advance, for we have made no significant inroads, as yet, into our unutilized resources, nor are we confronted with a generalized upward pressure on prices.

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

There seems to me to be a certain tendency emerging, at least temporarily, in a rather wide variety of recent statistical readings and individual reports. I refer to a note of moderation that has crept into numerous banking and financial flows. It is not, to be sure, an all-pervasive development. The equity market deserves to be excluded from this generalization, although even there stock prices have been climbing more slowly as they have closed in on their December 1961 peak. I must also stop my generalization short of the question of the quality of credit. That subject remains a moot area for judgment; centralized factual evidence is painfully inadequate regarding the underlying question of the quality of new credits being put on the books. But in the markets for debt securities, and particularly in the banking system, the flow of statistics now gives a rather more moderate cast to a number of trends--including some that might previously have been regarded as a bit on the immoderate side.

To begin with, interest rates have reacted quite moderately to the substantial improvement in the business forecasts of recent weeks. Looking back on the year to date, and taking into account realignments in connection with Treasury debt lengthening operations, one can observe a gradual upward drift in yields on U. S. and municipal government obligations, and also some upward adjustment of yields on corporate new issues. These rate movements could be judged, in retrospect, to have already involved a good deal of discounting, by dealers and investors, of the business improvement to date, and also a discounting of some further lessening of monetary ease as well. While we have heard some stories of long-term investment funds being withheld for a time, we have seen few evidences of anticipatory borrowing, and as a consequence markets have not found it hard to handle 1963 demands, or to work out of the consequences of occasionally over-aggressive professional actions.

Changes in the banking system appear rather striking when one views April figures in isolation, but upon closer examination the more extreme of these changes appear as an unwinding of earlier departures from usual borrowing patterns, rather than as major new developments. Thus, the concentration of Treasury cash borrowing in the first quarter of this year led to a $2-1/2 billion seasonally adjusted build-up of Government securities in bank hands, but this was entirely wiped out with the passage of April, as banks redistributed previous acquisitions and new Treasury financing was atypically low. Total bank holdings of municipal securities jumped sharply in April, but chiefly because of a heavy purchase of special New York State tax anticipation obligations by New York banks; apart from that, bank net acquisitions of municipals were of more moderate dimensions than earlier this year or last. Business loans rose $400 million in commercial banks in April, according to the new seasonally adjusted statistics, but this chiefly reflected the modest size of loan paydowns following the smaller than usual tax date borrowing in March. Averaged together, March-April business loan increases about equalled January-February 1963, and were about half the average for the fourth quarter of 1962. There was no visible sign in the April loan figures of any resort to bank financing by businesses that might be building steel inventory.

Bank lending to consumers slowed in March and April. And security loans at banks declined enough, seasonally adjusted, to offset the run-up in such credit that occurred during the heavy financing schedule in February and March. Of all the major bank loan categories, only real estate loans appeared to continue to grow at a pace commensurate with that of last fall. Even in this credit sector, net first-quarter expansion is estimated to have been slower than last year, but the slowdown appears to have been concentrated among nonbank lenders.

Adding all these bank earning asset trends together, total bank credit growth in the first four months of this year averaged about a $13.5 billion annual rate, one-fourth less than last year (+$18.5 billion).

On the deposit side, there are also some signs of greater moderation in the trend of time deposits. Total time and savings deposits at commercial banks increased only about half as much in April (10.3 per cent annual rate) as would have been projected by the 18 per cent annual rate of growth characteristic of the first quarter of 1963. The slowdown appeared to extend to both savings deposits and certificates of deposit, reflecting partly increased tax date withdrawals, but also, as detailed data from the Chicago District suggest, some slowing in the rate of new deposit inflows. Data for other savings institutions are not yet available beyond the first quarter, when inflows were very strong, and so we cannot judge whether this easing trend has since spread or been offset outside the commercial bank sector. We do hear, however, of a number of bank management decisions to go slow on further solicitation of savings deposits and certificates of deposit. Pressures to reduce rates paid are evident in the savings and loan field, and may also be substantial if less well advertised among commercial banks.

In the meantime the money supply moved up again in April, continuing its see-saw upward course of recent months. This latest advance appeared to draw a bit more support than did the preceding increases from a rundown of Government deposits and a reduced diversion of deposits into time form. But this may also reflect the public's desire for a somewhat greater amount of money to handle its flow of transactions. At its April level the money supply was only 2-1/4 per cent above a year earlier, compared with a first-quarter to first-quarter GNP increase of 5 per cent. With the total of money balances having been under downward pressure in recent years because of the attractive interest returns available on near-moneys, it should not be surprising if substantial further advances in business bring demands for additional money stock which are more commensurate with the percentage increases in GNP than they have been in some past phases of economic expansion.

Given the variety of places in the financial system in which signs of some moderation are appearing, one is tempted to look for a general source or sources of tranquilizing influence. Indeed, a good many tranquilizers may be at work, and I would not pretend to be able to identify all of them. Some credit may need to go to the slightly less easy monetary policy pursued since last December, with its slightly lower free reserves and slightly higher bank borrowings and short-term rates. Growing internal funds of business, not yet utilized to finance inventory additions or prospective capital investment, are also undoubtedly moderating current loan pressures on the banking system. But a substantial measure of the credit for the tendency to moderate some of the more extreme banking trends of the last year or so may belong to the ultimate common sense of bankers themselves, who are finding in their balance sheet ratios, earnings and expense statements, and credit quality changes some concrete reasons for reconsidering their previous policies, particularly with respect to the aggressive bidding for time and savings deposits, consumer credit, and municipals. Whether such a trend inside parts of the banking system can persist, and can spread to other areas of credit extension, only time will tell. An observer is entitled to a certain degree of skepticism in these respects. But the Committee will want to have these current moderating tendencies in mind, along with the other considerations which press in upon it, in reaching its conclusion as to an appropriate posture for policy at this juncture.

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

Transfers of gold, foreign convertible currencies, and dollars to foreigners in April may be guessed at $500 million, on the basis of the fragmentary and preliminary weekly data. This would be twice as much as the monthly average for the first quarter, and would bring the annual rate for the first four months of the year back to the 1962 level of $3.6 billion. Analysis of the increase in the deficit in April must wait for more complete data. Tentatively, however, it may be assumed that, apart from some adverse seasonal shifts, the U.S. trade surplus declined from the high February-March levels which reflected the settlement of the dock strike; that cessation of the pressure on sterling put an end to inflows of funds from London; and that market confidence in the new Canadian government led to increased outflows of funds to Canada.

U.S. gold holdings declined slightly, with the usual monthly gold sales to Austria, France, and Spain partly offset by purchases from Brazil and Turkey. For the first four months, the annual rate of the decline, $450 million, was much lower than the annual figures for the last five years. Gold sales have been kept down, first, by special Treasury borrowing abroad of $480 million; second, by the pressure on sterling, which induced the Bank of England not only to sell gold to the U.S. Treasury but also to refrain from converting into gold the dollars it received as aid from European central banks; third, by the current practice of the Bank of France of converting only a fraction of its dollar accruals into gold, while using as much as possible of the remainder for paying off dollar debts (e.g., last month $60 million to the World Bank); and perhaps fourth, by a possible increase in Euro-dollar transactions, which might explain a sharp rise in non-official British dollar assets. These factors, however, cannot be expected to remain effective throughout the rest of the year.

Economic developments abroad continue to favor U.S. export prospects. Europe has resumed its economic upswing, the interruption of which during the winter was apparently caused mainly by the unusually harsh weather. Moreover, European wages continue to rise, as shown by today's settlement of the German metal workers' strike. Some European governments, including the French, seem to be resolved to take more severe measures against the threat of inflation; but these measures will hardly be fully effective before the end of the year. Moreover, some others, and especially the United Kingdom, remain firmly committed to expansionary policies. Thus, if only U.S. export industries managed to avoid price increases, the competitiveness of U.S. industry in world markets should continue to improve.

At the same time, however, further European expansion will continue to make investment in Europe more attractive to international capital. Under these circumstances, there is little hope of further reductions in European interest and yield levels, or of an increased flow of European private funds to foreign countries, which would relieve foreign demands on the U.S. capital market; and the outlook for the long-term capital balance, both in the fixed-interest and the equity sector, remains unfavorable. For the first four months of the year, foreign security issues in New York, overwhelmingly representing Canadian borrowing, have continued at an annual rate of $1.5 billion.

Recorded outflows of short-term capital seem so far to have remained modest. Yesterday's reduction in Canada's discount rate promises a curtailment of flows to Montreal. But the disappearance of the covered interest-rate advantage for U.S. Treasury bills over U.K. Treasury bills may give impetus to flows to London. Unfortunately, the United Kingdom seems to welcome such inflows for the sake of its own payments balance.

At this point the Chairman turned to Mr. Hayes, who commented informally on his recent trip to Europe during which he visited in London, Paris, and Rome and attended a monthly meeting of the Bank for International Settlements in Basle.

With respect to his visit to London, Mr. Hayes observed that the budget message, which he heard delivered by the Chancellor of the Exchequer, was well received. It seemed to be generally agreed that the United Kingdom was in need of expansionary measures and that the proposed budget was in the right direction. There appeared to be no particular concern from the standpoint of deficit financing or adverse effect on the British balance of payments. It was the general view that the expansionary effects of the budget would be moderate and gradual, so that there would not be too much effect on imports this year. The outlook for the pound sterling was regarded as reasonably good; invisibles in the balance of payments seemed to be showing marked improvement. The talk of devaluation had now died down. There was a rather general feeling that the British might have to resort to a drawing from the International Monetary Fund to fund the temporary borrowings from Continental central banks earlier this year. However, although it was too early to judge whether the flow of funds out of Britain that had occasioned those borrowings was going to be reversed, there was some hope that the British could avoid funding them. There was an undercurrent of discussion about possible liberalization of certain banking practices in England, with some disposition to favor more flexible rate policies, but this was still in the talking stage.

In France, Mr. Hayes said, there was much official concern about wage pressures. One difficulty lay in nationalized industries, where productivity was not increasing, being forced to follow the kind of wage trend being followed in the more productive industries.

Attempts were being made to stimulate the capital market, with the general objective of promoting long-term lending activity and also freeing the Treasury bill market. As to the balance of payments, it was expected that the surplus in 1963 would be below 1962, but still quite substantial. Gold continued to occupy quite an important place in private investment decisions; some investment trusts were carrying substantial quantities of gold. There had apparently not been any real tightening up on permission for Americans to invest in France, although there may have been a little increase in the time lag involved. There was still a general feeling that American investment was appropriate, provided it did not result in domination of a major industry. There seemed to be a growing awareness of the competitive ability of American industry, with some concern also about competition from Germany and Britain.

In Italy wage pressures were a popular topic of conversation. The increase last year averaged 16 per cent, and the figure could go as high this year. Retail prices were up about 9 per cent in the past year. However, there was no disposition to check credit expansion. If anything was going to be done about the wage-price spiral, apparently it would have to come primarily from restraint on the part of labor and management, with Government backing. The balance of payments had been in basic deficit in recent months, but this was offset by short-term capital inflows. This was a season when revenues from tourism were not running as heavy as in the summer, and the payments position seemed fairly close to equilibrium. Strong efforts were being made to improve the capital market, with monetary measures aimed at reducing short-term rates in the hope that this would stimulate lower long-term rates. To some extent, this had been effective in recent months; the capital market was now better than last fall.

The April meeting of the Bank for International Settlements at Basle was quiet, with no problems of great concern evident at the moment. Views on the U.S. dollar seemed to reflect confidence as far as the immediate outlook was concerned, and this applied also to general discussion of the dollar on the Continent. At the same time, some observers were quite concerned about the continuing U.S. balance of payments deficit, as evidenced by the Annual Report of the Netherlands Bank. Uneasiness was sensed on the part of a number of central bankers about the position of the dollar in the longer run, a concern as to whether this country was really getting the balance of payments problem under control or whether there was a persistent, underlying problem that had not been dealt with adequately. Some potential risk also was indicated of temporary measures being strained too far. There was always the danger that countries would consult among themselves and then become less amenable to bilateral arrangements with the United States unless they saw greater assurance that this country was making the kind of progress it should be making on its balance of payments problem. In Mr. Hayes' judgment, monetary policy had an important part to play in this effort.

Chairman Martin then turned to Mr. Young for a report on the most recent meeting of Working Party 3 of the Economic Policy Committee of the Organization of Economic Cooperation and Development, and Mr. Young commented as follows:

> At the most recent Working Party 3 meeting, held in Paris last week, a review of U.S balance of payments policy was again the principal item of the agenda. We had been advised in advance that we would confront a European view that the U.S. had not as yet presented to the group a comprehensive program for the correction of its payments deficit. In the light of this advice, the main task of the U.S. delegation was considered to be a full explanation of the longer range and shorter term elements of an integrated U.S. program, together with a broad indication of the pace at which it was expected to be achieved. This was done effectively and, we thought, persuasively by the head of our delegation.
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> For the longer run, he emphasized adjustment through the work-out of fundamental competitive forces, supplemented by redistribution of aid and defense burdens and by gradual reduction of the capital outflow through reciprocal credit and capital market adaptation. For the shorter run, he stressed some further tying of aid, more stringent control of Governmental expenditures abroad, additional debt prepayment and defense expenditure offsets, some intermediate-term borrowing by the Treasury in securities denominated in foreign currencies, some increase in U.S. liabilities to willing dollar holders, and some settlement in gold.
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> This presentation received adverse comment on four grounds:
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> (1) The length of the projected period--two to three years or even longer--to achieve equilibrium;
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> (2) the size of the U.S. deficit considered possible for 1963--$3 billion;
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> (3) the failure to assign a larger and more

active role--short-term and longer-term--to monetary policy: and because of

(4) the inflationary burden that the U.S. deficit was placing on surplus countries.

The U.S. delegation was subjected to special questioning regarding the bilateral use of the new special Treasury issues denominated in foreign currencies. It was said that the specific issue raised by resort to this instrument was whether the U.S. in fact was not circumventing the multilateral disciplinary mechanism of the international payments system which the International Monetary Fund was established to provide. And if the U.S. felt that, because of its special reserve currency status, it could not draw from the Fund to bridge over a persisting disequilibrium, was it not then the duty of Working Party 3 to exercise a special surveillance and disciplinary function with respect to the U.S. payments deficit?

The U.S. response to this line of logic and questioning was that these special Treasury issues were merely intended to provide the U.S. a means of encouraging additional dollar holdings, without exchange risk, by countries desiring to hold them during a period in which the U.S. was striving to improve its payments position without actions that would disturb financial markets or distort patterns of world trade. It was also pointed out that this new type of Treasury security filled a gap in available international monetary instruments in that it provided an instrument, free of exchange risk, falling between the short-term swap and the longer-term (3-to-5 year) IMF drawing, and therefore constituted a modest but significant supplement to the media for international liquidity.

As regards the issue of the use of the new instrument as a device for circumventing established procedures for preserving international monetary discipline, it was pointed out that the U.S. was in no way avoiding these procedures; that the U.S. was, as other IMF members, subject to regular, searching review as to its balance of payments policies; and that the terms of reference of Working Party 3 did not include the exercise of any special disciplinary function with regard to any country.

In the Chairman's concluding remarks he noted that, while U.S. expansion and prosperity were essential to a strong U.S. payments position, Working Party 3 agreed that there was urgent need to supplement such expansion by an active monetary policy to reduce excessive internal liquidity. He further stated that the group had agreed that U.S. monetary action to raise domestic interest rates should not be nullified by increases in interest rate levels of the surplus countries. With regard to U.S. use of special Treasury issues denominated in foreign currencies, he said the provisional Working Party 3 view was that their employment was appropriate only if there were definite indications of improvement in the U.S. payments position. Finally, he expressed for the European membership of the Working Party strong reservations as to the U.S. policy of tying its foreign aid, saying that this militated against rather than helped restoration of U.S. competitiveness.

The Chairman's summary seemed to the entire Working Party group to carry much further than had its discussion and to convey explicit agreement among the Europeans on points not fully or extensively discussed in the meeting. Since the meeting had at that juncture extended beyond its scheduled termination, it was agreed that the Chairman would expose his summary for group reaction and comment at the opening of the next meeting of the Working Party to be held on the 19th and 20th of June. Since time had not been available for an exposure and discussion of U.S. domestic liquidity and monetary developments, such a presentation was placed, as a priority item, on the next meeting's agenda.

Another part of this last meeting's agenda was a general discussion of French capital market organization. This organization contrasts sharply with the free market type with which U.S. students are familiar since it is geared to channeling a large part of national savings through the French Treasury at interest rates that are determined by Treasury policy rather than by the market. An official commission has recently been engaged in a searching examination of the French market's structure, but the commission's report was not available for this meeting's discussion. And there were no hints as to whether the report would include recommendations looking toward a freer French capital market.

A final section of the meeting was given over to a round table report of recent economic and balance of payments developments in the major European countries. This review produced no information with which the Open Market Committee is not already familiar. However, both the French and German delegations were mildly chastised in the discussion for pursuing monetary policies mainly oriented to their domestic problems but at variance with the payments surpluses of their respective countries.

After a brief discussion during which Mr. Young expanded on certain aspects of his report, Chairman Martin called for the usual go-around of comments and views on economic conditions and monetary policy beginning with Mr. Treiber, who presented the following statement:

> The business atmosphere and business outlook have improved in recent weeks. Consumer buying has been a continuing element of strength, and consumer confidence appears to be high. Housing starts have risen sharply following the winter slump. The recent McGraw-Hill survey of capital spending plans reinforces earlier indications that capital spending would move up after the first quarter. Apparently the new depreciation schedules and the 7 per cent tax credit are having a favorable effect on plant and equipment spending. Because, however, of the part played by temporary factors, such as the buying stimulus associated with fears of a steel strike, the magnitude of the prospective rise in business activity is uncertain.
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> Prices generally continue to be stable, but there are some indications of a firming of raw material prices for both immediate and future delivery. It is too soon to tell the effect of the recent selective increases in steel prices.
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> Employment has risen, but there is little change in unemployment. Indeed, the problem of unemployment is of about the same magnitude as it was a year ago.
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> A reduction in commercial bank credit in April reflected contraseasonal reductions in bank holdings of Government securities and in total loans, primarily security loans. In addition, there was a contraction of loans to sales finance companies. On the other hand, there was strength in business loans, with modest advances rather widely based. There was a $1/2 billion rise in the daily average money supply in April. While bank liquidity is at about the level of early 1961, it is still adequate. There continues to be plenty of nonbank liquidity.
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> Preliminary statistics for April indicate a worsening of our balance of payments deficit. The deterioration

occurred despite a temporary decline in foreign bond issues in our capital markets and reports of an increase in purchases of United States corporate stocks by foreign investors. Imports in March continued at a relatively high level; it is not clear to what extent this reflects the deferment of foreign shipments to this country because of the dock strike. There is no indication of any prospective improvement in our balance of payments. On the contrary, large foreign borrowings in our capital markets are in prospect, and the rise in business activity may stimulate greater imports. Although our monetary gold stock has remained unchanged since the last meeting of the Committee, it is clear that there will be substantial gold losses as the year progresses, and perhaps fairly soon. Our balance of payments, both actual and prospective, is bad.

The Treasury is in the midst of a refunding operation. The new issues are to be paid for by the surrender of the maturing issues a week from tomorrow. Thus, "even keel" considerations would rule out any major change in Federal Reserve policy in the next week or so, but "even keel" considerations should not preclude some moderate movement toward a firmer money market sometime during the statement week beginning May 16.

It seems to me that our bad balance of payments calls for Federal Reserve action. While an immediate rise in the discount rate would seem premature, a further modest move through open market operations toward somewhat less ease would seem advisable. It should be possible to initiate such a move a few days after May 15 when the Treasury refunding operation will have been completed. The objective of such a move would be a Federal funds rate consistently at the 3 per cent discount rate, and a three-month Treasury bill rate at nearly 3 per cent; such a move would probably involve a modest reduction in free reserves and a modest increase in member bank borrowing. Such a cautious movement toward a bit less ease would call for a change in the directive to show such a change in policy. The change in the directive should recognize the improved domestic outlook, indicate that greater weight is being placed on balance of payments considerations, and make clear that no action would be contemplated until the Treasury's refunding is concluded.

Mr. Ellis said that economic activity in New England continued at a high level, but without significant signs of appreciable expansion.

Manufacturing output in March was at virtually the same level as in January of this year and in March 1962, although within the category of manufacturing there were, of course, various shifts and counter-balancing movements. In the electronic field, competition from Japan was a factor in pulling the employment level down 2 per cent below a year ago. Shoe and cotton goods manufacturers also blamed declines on imports. Shoe production in the first quarter of this year was 6 per cent under the first quarter in 1962. Total unemployment rose slightly in March, on a seasonally adjusted basis, to a level virtually identical with the national average, although insured unemployment figures were a little less favorable than for the nation. Retail demands continued strong, and bank debits had risen to a new peak. Businessmen reported an increasing volume of new orders.

Figures for First District weekly reporting banks reflected a seasonal leveling off of business loans since the March tax date. There was a continued shifting from short-term Government securities to other securities, primarily municipals.

Turning to the national picture, Mr. Ellis expressed agreement with the view that it was rather difficult to make a positive case for a shift to less monetary ease based solely on an analysis of the domestic economy. On the other hand, the economy seemed better able at present to stand a lesser degree of ease; such action may have already been discounted to some extent. Therefore, in the formulation of policy the Committee seemed to have more freedom of choice than in past months. On the international side, there had been a worsening of the balance of payments position in April, due partly to capital flows. Looking at the impact of credit policy in the past month, the staff memorandum indicated that free reserves had averaged a little higher, member bank borrowings a little lower, and the Federal funds rate a little lower on average.

As Mr. Ellis saw it, the choice between no change in policy and a shift to slightly less monetary ease involved a matter of closely balanced alternatives. He did not feel sufficiently confident of the strength of the business situation and the future trend to suggest at this time a definite shift of policy to less ease. What did seem feasible to him was experimentation with short periods of less ease, allowing some additional firmness in money markets to develop from market factors that he thought might appear this spring. If this experimentation should demonstrate the feasibility of a lesser degree of ease, with the economy continuing to expand, the Committee could then decide to consolidate its position. For this experimentation he would suggest moving toward $250 million as an initial target for free reserves, with less trading in Federal funds below 3 per cent. He would expect some modest increase in member bank borrowing and a tendency for the short-term rate to rise toward the discount rate, but he would not recommend changing the discount rate at this time. If a course such as he had outlined should be decided upon, it would be necessary to revise the policy directive accordingly.

Mr. Irons said there had been no significant changes in the Eleventh District in the past three weeks. It would probably be accurate to say that there had not been quite as much recent improvement in economic activity in the District as seemed to be reflected nationally. It was more a matter of moving along on a high plateau, with some indicators up slightly and some down. Industrial production was holding at the March level, which was down a point, reflecting largely petroleum production. Construction activity continued at a very high level and established a record during the first four months of the year. Employment continued to rise slightly, and unemployment had declined to 5.0 per cent of the labor force on an unadjusted basis. Department store sales were running about 5 per cent ahead of a year ago and the agricultural situation looked promising, with rainfall in a large part of the District improving expectations.

Loans and investments of District reporting banks were both up in the most recent period, with an increase in investments in both Government and other securities, while demand deposits were down a bit. Time and savings deposits growth lagged somewhat during the past three-week period. The banks seemed to be adequately liquid. They were about on balance as to Federal funds for the past three weeks, and few banks were borrowing from the Reserve Bank.

Mr. Irons noted that the national picture reflected continuing improvement, with increased confidence in the business outlook. General attitudes seemed much more favorable, judging from views expressed both by Government spokesmen and businessmen. If one could eliminate the unemployment figure, most of the economic indicators appeared quite good. The balance of payments situation continued to be a problem, apparently of about the same degree of difficulty that had prevailed for some time.

Mr. Irons went on to say that he was beginning to wonder whether a problem might not be developing on the domestic side in the form of deterioration in the quality of credit. He seemed to be hearing more comments about heavily indebted borrowers having difficulty in maintaining their positions, the tendency toward more questionable mortgage coverages, the extension of maturities, and about inflationary tendencies and speculative movements that were beginning to show up in noncommodity areas, rather than in the price of goods being sold. He wondered whether monetary ease might not have reached the stage where it was stimulating sectors other than basic production, employment, and the distribution of goods.

In the light of developments that raised warning flags, Mr. Irons raised the question whether it might not be appropriate to move in the direction of slightly less ease. The critical point seemed to be the matter of timing, but in view of some of the warnings that he thought he saw in the domestic picture he felt it might be appropriate to move in that direction. Accordingly, while he was not firm in his convictions, he would support a moderate move toward more firmness if that should be the Committee consensus. This would contemplate, according to his analysis, free reserves in the area of $200-$250 million, a Federal funds rate more firmly at 3 per cent, and the bill rate at or close to 3 per cent, and he would expect some increase in member bank borrowing. He would not, however, change the discount rate at this time. If a policy such as he had outlined should be decided upon by the Committee, it would be necessary to modify the policy directive.

Mr. Swan reported that the improvement in business conditions in the Twelfth District appeared to be a little less strong than in the nation generally, in contrast to the situation during most of 1962. The number of nonfarm wage and salary employees was virtually unchanged in March on a seasonally adjusted basis. In fact, from January to March the gains in distribution and service industries were just about offset by losses in commodity-producing industries. During the period April 3 to April 24 the loan increase at weekly reporting banks was considerably less than in the comparable period of 1962, and withdrawals from savings deposits--primarily for tax payments--were about twice as large. This implied that a significant amount of the growth in savings accounts since the increase in interest rates may have reflected accumulation for substantial periodic expenditures. The growth in time and savings deposits at weekly reporting banks had been somewhat slower this year than in 1962. From the first of the year through April 24 the rate of increase of savings deposits was only about half as large as in 1962.

Mr. Swan agreed that a shift in monetary policy seemed to be getting closer and closer to the point of decision. However, he believed that the improvement in the business situation did not yet warrant any change in policy. Steel production and orders were affected by hedge buying against the possibility of a strike. Looking at over-all measures of unemployment, retail sales, and industrial production, along with the moderation in financial developments referred to by Mr. Holland, he did not find indications that a strong upward surge of economic activity was imminent. Certainly the month of April showed no cumulating of the March advances.

Accordingly, Mr. Swan said, he would continue for the next three weeks the same policy that had prevailed during the past three weeks. The economic upturn was still at an early stage, and he would prefer to give it a good chance to continue. If credit demands began to increase substantially in May, and if it were found that the supply of additional savings had slowed down, some market tightening would seem probable. It seemed preferable to him to await such a development, if it was going to occur, rather than to take deliberate policy steps in anticipation. The balance of payments, of course, still presented a serious problem, but he did not think it was overriding in importance compared with the domestic situation. He would recommend that there be no change in the discount rate at this time, and no change in the policy directive except for a possible technical amendment.

Mr. Deming said that the general feeling in the Ninth District was one of optimism, which to some degree seemed justified. Crop prospects were excellent in terms of moisture and an early season. Retail sales were good, particularly auto sales, and farm implements were moving very well. On the other hand, some developments indicated nothing better than an even keel, and some others were even less encouraging. Nonagricultural employment and industrial production statistics showed at best level activity through March. The broadest measure, personal income, showed a declining trend on a seasonally adjusted basis from the first of the year and no net gain since early last fall. Relative to a year ago, however, March personal income in the District was up more than for the country as a whole, and the wage and salary and nonfarm proprietor sectors showed more strength than the total. The iron ore shipping season opened late on Lake Superior because of the heavy ice, but ore stocks at steel mills were quite high and the outlook for ore shipments was not particularly optimistic. Cattle feeders had been hard hit by recent livestock price declines, and many had delayed marketings. Some feeders might well be badly hurt. Some decline was seen in mortgage loan quality, with lower down payments and longer maturities evident since the first of this year. Delinquencies, defaults, and foreclosures were still quite low but showed some tendency to rise. In sum, the statistical evidence indicated no strong upward thrust in activity such as seemed to be evident at the national level.

Ninth District banking developments continued to show mixed trends between city and country banks. Following a very strong performance in bank credit, loans, and deposits at both classes of banks in the fourth quarter of 1962, the first quarter of 1963 showed total bank credit and bank loan growth of greater than seasonal proportions but weaker than in the fourth quarter of 1962 at both classes of banks, with relatively stronger expansion at country than at city banks. The change in total deposits in the first quarter at country banks was just as strong as in the fourth quarter of 1962, but at city banks deposits fell about seasonally in contrast to more than seasonal growth in the latter part of 1962. City bank loans, investments, and deposits exhibited weakness in April after seasonal adjustment, as did country bank investments and deposits, but the latter banks continued to show above-average loan strength. This atypical behavior in country bank loans probably reflected in large part the financing of cattle feeders, who had withheld stock from the market because of price drops. If the paper losses of the cattle feeders became real, country bank loans might be expected to stay up, partly because of the losses and partly because they would have to carry heavier lines of production credit during the crop-growing season.

Turning to credit policy, Mr. Deming observed that Mr. Koch's comment at the April 16 meeting that the emphasis in speaking of "slightly less ease" should be put on the word "slightly" rather than on "less ease" seemed appropriate. Any difference between the posture of the System just prior to December 18, 1962, and at present was not observable to the naked eye, although it probably was true that the tone of the market was a shade firmer. In the three weeks ended December 19, excess reserves averaged $445 million; in the four weeks ended May 1, they averaged $441 million. Member bank borrowings averaged $121 million in the three weeks ended December 19; they averaged $124 million in the four weeks ended May 1. Free reserves averaged $324 million in the three weeks ended December 19; they averaged $317 million in the four weeks ended May 1. The three-month bill rate was not significantly different. Dealer loan rates were a bit higher, and Federal funds hit 3 per cent somewhat more often, but not much more often.

Mr. Deming also observed that the balance of payments problem loomed about as large as it did six months ago, although comment on it seemed to have moderated somewhat. Of course, if the Canadians could not have borrowed in the U.S. capital market, the U.S. payments position would have been much closer to balance. They did borrow, however, and apparently were going to continue to do so.

Mr. Deming went on to say that he had done some analytical work on U.S. bank foreign lending. In brief, this study showed what everyone knew: a strong uptrend in both long- and short-term bank lending to foreigners since 1953 and a sort of plateau series in such loans, with successive plateaus at progressively higher levels. When loans to foreigners were plotted as percentages of weekly reporting bank total loans, and particularly as percentages of New York City bank loans, the steps were very apparent. And when these in turn were plotted against free reserves, there seemed to be a rough kind of relationship, lagged a bit to be sure, between high free reserves and a higher plateau of bank lending to foreigners.

It was Mr. Deming's feeling that a bit too much liquidity may have been pumped into the banking system and that there had been some "spillover effect" on foreign lending. It might be significant that the slightly lower level of free reserves in the latter part of 1962 was accompanied by a slightly lower level of foreign loans relative to total loans.

Mr. Deming expressed the view that it might be useful for the Committee to move a bit toward lesser ease. While this would not cure the balance of payments problem, it might be of some assistance. It might also curb gently any tendency of the banks to push speculative and unsound credit extension, if any such tendency existed. With a relatively weak private sector demand for loans, it should not choke off needed and sound credit. He would take this step via reduced reserve availability without any particular emphasis on rate hardening. It might be that rates would not advance by any appreciable amount; if there really was spillover, they should not advance very much. In any event, he would suggest the use of a lower level of free reserves as a guide rather than the short-term rate--perhaps a level of $200 to $250 million of free reserves. He would not resist an upward rate movement, but he would not seek it as an end. This policy could be begun without much in the way of an overt move--if the reserve estimates are reasonably accurate--merely by letting market factors absorb reserves in the next two weeks. If there should be an economic upswing on the way, that should help over the longer period. He thought this would be worth doing, and that it could be done without harm to the domestic economy. If it was decided upon, there should be an appropriate change in the policy directive, but he saw no reason to change the discount rate at this time.

Mr. Scanlon reported that Seventh District business activity continued to improve in April. Manufacturers' new orders, especially for capital equipment and steel, continued strong. Employment in all

District States was appreciably above last year in March, and reports from local employment service offices indicated that increases in the second quarter would be more than seasonal.

Steel orders continued very strong, but local experts believed that demand would taper off later in the month. While most types of steel products other than structurals had participated in the order surge, delivery times for sheets and strip had stretched out from three-four weeks to seven-eight weeks. It seemed that a reaction in steel production was inevitable. The highest estimates for the year as a whole were around 110 million tons, compared with a current operating rate of 133 million tons.

Producers of capital goods reported further increases in orders, with construction machinery especially strong. Orders for farm machinery continued excellent despite the prospective drop in net farm income in the Midwest.

The higher level of new orders had encouraged many manufacturers to test their markets by announcing price increases. This was true not only in steel and aluminum but also in such varied lines as electrical equipment, bearings paper products, and glass. A stronger tendency in this direction was thought to be noted than at any time since the current expansion began two years ago. As to the auto market, deliveries to customers in April were the largest on record.

Savings continued to flow to financial institutions at a high rate, Mr. Scanlon said, somewhat less rapidly than a year ago at Seventh District banks and somewhat more rapidly at savings and loan associations. The volume of time certificates issued by banks was rising much less rapidly than last year. Many banks had de-emphasized savings promotions and apparently would like to cut rates paid on savings if competition would permit them to do so. Tabulations of new mortgage loans showed a further easing of terms and interest rates for March. Moreover, significant cuts in mortgage rates reportedly had occurred in April in some areas of the District.

While total credit outstanding at weekly reporting banks rose strongly in March, both in the nation and in the District, this performance did not continue in April. Some Seventh District bankers reported business loan demand to be relatively strong, but most of them indicated that they were vigorously seeking additional outlets for funds, including greater emphasis on accounts receivable financing and auto loans. According to a recent survey, most country bankers expected the demand for farm loans to be as strong or stronger than a year ago.

Mr. Scanlon said he was worried about some of the things Mr. Irons had mentioned so far as deterioration of the quality of credit was concerned. Like Mr. Irons, he felt that the matter of timing was important in considering a possible change in monetary policy. Although a close question was involved, he would recommend a continuation of current policy for the next three weeks. He would construe continuation of the current posture to imply achievement of moderate reserve expansion while maintaining, so far as possible, a stable money market as reflected primarily in short-term interest rates. Although business had strengthened further and expectations were more optimistic, he saw a distinct possibility of an inventory turn-around that would have a dampening effect beginning around midyear. In the meantime, the inventory buildup appeared to be beyond the reach of any moderate adjustment of monetary policy. He was disturbed by the increasing evidence that prices were being marked up on a lengthening list of items, and he expected that the System might soon be confronted with a gradual rise in prices while there were still sizable amounts of unused resources.

After commenting that he would not change the discount rate at this time, Mr. Scanlon noted that if the Committee should decide to move in the direction of lesser ease, it would be necessary to change the policy directive. If the directive were changed for any reason, he would favor deletion from the first paragraph of several phrases so as to omit the references to recent increases in bank credit, money supply, and the reserve base, the limited progress of the economy, and absence of inflationary pressures.

Mr. Clay expressed the view that it would be appropriate to continue essentially the same monetary policy in view of recent domestic and international developments. In fact, it could be said, he thought, that apart from Treasury financing the reasons for that policy remained much the same as earlier. While the international balance of payments problem continued to be intractable, it was clear that the domestic economy was in no sense operating under forced draft with strong demand pressures on resources, capacity to produce, and prices Hence, the economy was not generating the strong internal pressures normally associated with a balance of payments deficit problem.

While economic activity was showing some advancement, it had not given evidence of making much inroad on the economy's resource utilization problem. To be sure, the steel industry was operating at a much higher rate of capacity than earlier, but that development rested to an important degree on steel strike hedging. Moreover, there was the difficult question as to the extent to which the improvement in aggregate economic indicators might grow out of the same factor.

All in all, Mr. Clay concluded that monetary policy should continue to be a moderately stimulating one. The degree of improvement shown in domestic economic activity thus far was not sufficient, in his judgment, to warrant any lessening of the expansionary role of monetary policy. The discount rate should remain unchanged, and except for the reference to Treasury financing the substance of the current directive was in line with the monetary policy that in his opinion should be pursued.

Mr. Heflin reported that Fifth District business had continued to advance following gains in March that lifted the area economy above its former plateau. The initial upward movement was particularly strong in manufacturing, and the March rise in seasonally adjusted factory man-hours was stronger in the District than in the nation as a whole. Insured unemployment had decreased since the middle of March at a distinctly better than seasonal rate, and the Reserve Bank's latest survey suggested that the decline was continuing. The survey also showed business sentiment still buoyant; two-thirds of the panel expected further gains and most of the others foresaw continuation at present levels. On balance, the respondents rated nonfarm employment, bituminous coal mining, construction, and retail trade stronger than three weeks earlier. Manufacturers in general continued to report rising levels of new orders and shipments as well as increased employment and longer workweeks Textile firms, however, were still hampered by fluctuations in demand stemming from widespread uncertainty as to how cotton prices would behave if action was taken to alter the two-price system. Business, consumer, and real estate loans at weekly reporting banks continued to show somewhat greater strength in the District than in the nation as a whole.

Turning to national conditions, Mr. Heflin noted that the resurgence in economic activity had now continued long enough to indicate that, even after discounting the effects of inventory accumulation in steel and other temporary factors, there had been a definite, even though modest, improvement in the economy. The improvement seemed to be quite general, and no major decline or unfavorable development had been announced for more than a month. In addition to the strength in automobile sales and other retail sales, which had been evident for several months, personal income had continued to rise slowly, and industrial production had broken out of the narrow range within which it fluctuated during most of 1962. There was evidence also that business investment was moving up, including the most recent estimate that outlays for plant and equipment this year would be 7 per cent above last year's figure, in contrast with an estimate of 3 per cent made last fall. While manufacturers' new orders showed no significant change in March, the total of unfilled orders increased nearly a billion dollars, and the increase for the first quarter was almost two billion dollars, which offset about two-thirds of last year's decline. While it was too early to be sure, these gains plus the improvement in business sentiment might mean that the recovery which began in February 1961 had its second wind after last year's pause.

Mr. Robertson presented the following statement:

> The evidence of improving business that is being reported around this table is certainly welcome news. I hope, as all of us must, that the pickup will continue, firmly but gradually. If it does, then at some point it

would be necessary to shift to a substantially less easy monetary policy.

But, in my judgment, that point has not yet been reached. Strengthening business expectations and investment plans strike me as still too tender to accept with impunity any increase in interest rates or restraint upon liquidity or credit availability. Moreover, current activity is certainly being bolstered, and third-quarter activity will probably be dampened, by the effects of anticipatory purchases of steel in the current quarter. It would seem wise to wait to see how well the economy withstands this possible third-quarter snapback in steel before trying to test its ability to grow under tighter monetary conditions.

I say this partly because I think that any movement to a policy of less ease would have to be a fairly substantial one in order to be useful to us in the international arena. In this connection, let me point out that we have apparently obtained precious little gain in the way of international financial confidence from the three very modest tightening or "probing" actions that we have already undertaken in the past two years. Some might argue that such changes in policy have a constructive role to play when sizable capital outflows are occurring of a type that is responsive to a few basis points' differential in interest rates. But such flows have not bulked large for a number of months.

All this means to me that the appropriate policy prescription for the next three weeks is to wait: watch and wait with policy targets unchanged for a little while longer, until--hopefully--domestic business expansion and the balance of payments could both justify and respond constructively to a move toward a less easy policy. We have waited this long; a few more months may now be all it will take to prove the essential wisdom of the course that we have followed.

Mr. Shepardson noted, with reference to the reports of hedge buying of steel, that this factor was hardly going to be affected one way or the other by monetary policy. In general, he added, the reports on economic activity were encouraging. The lack of significant change in the rate of unemployment was a problem that had persisted for a long time. Here again was a factor that involved elements beyond the direct impact of monetary policy.

Mr. Shepardson agreed with the view that it was time to begin experimenting in the direction of slightly lesser ease. As he had mentioned at previous Committee meetings, in his opinion there were evidences of inflationary pressures outside the normal gauge of price movements. Also, according to the material furnished by the staff on reserves, it appeared to him that required reserves against private deposits were continuing to increase at an annual rate of better than 4 per cent, as against the growth guideline of 3 per cent that had been discussed for some time.

For all of these reasons, Mr. Shepardson said, he concurred with the view that a target of somewhat less ease was indicated. If this should be the decision of the Committee, a corresponding change in the policy directive would be required.

Mr. King commented that it was apparent that the domestic economy was continuing to make some progress. So far as monetary policy was concerned, he felt that this was probably a good time to squeeze some water out of the brakes, although not until the middle of this month for reasons that had been mentioned earlier during this meeting. A very modest move toward less ease would be generally in accord with the views he had expressed at the April 16 meeting of the Committee, and he would envisage basic target figures such as outlined by Mr. Irons. As to the policy directive, it seemed to him that a directive somewhat along the lines of the one he had suggested at the previous Committee meeting would be appropriate for the next three weeks. He would not change the discount rate at this time.

Mr. Mitchell suggested that the Committee should consider the matter fully before any decision was reached to move in the direction of less monetary ease. If such a step was taken, he felt that the Committee should act in no uncertain fashion; action in an unobtrusive way would not get any benefit from the reaction of foreigners who presumably would be interested in knowing that the Committee had shifted policy. He believed there had been a disposition on the part of Committee members to watch the domestic economy very closely with the thought of moving toward a firmer monetary policy as soon as there were signs of definite improvement. The economy was now showing some signs of improvement, but in his opinion it should be given a chance to move further ahead before there was any shift away from the present posture.

Mr. Mitchell expressed agreement with the view that in the area of credit extension there had been some deterioration in terms and quality. However, he did not feel that a deterioration in the quality of credit was necessarily bad if the price was right. An insurance company was willing to insure a man against death if the price was right, and the same principle would seem to hold true in the field of credit. If the price was right, the credit was good.

There was a flood of savings to be dealt with, Mr. Mitchell pointed out, and he did not believe that monetary policy could move strongly, vigorously, and effectively against this flood of savings, which had been engendered to some degree by rate competition for savings funds but basically reflected other factors, including changing aspiration on the part of consumers. In 1962 total savings in financial form, including bank deposits, share accounts at savings and loan associations, and amounts placed with insurance companies, amounted to $41 billion; meanwhile, direct savings still increased. The increase of $41 billion compared with a figure of $35 billion in 1961 and an average of $22 billion in the previous five years. This was what had put real pressure on capital markets, with a great deal of focus on the mortgage market where liberalization of terms had occurred in many places. In his opinion, the free market remedy was not higher but lower interest rates Liberalization of terms occurred because lenders did not want to break the rate; but if the rate had declined there would not have been the need to liberalize terms in order to clear the market. Accordingly, before a deterioration in the quality of credit was used as a reason for the Committee to tighten the monetary screws, he felt that one should think twice. In his view a different course of action was indicated.

In conclusion, Mr. Mitchell expressed the view that this was a a good time not to make any move, and instead just to stand fast.

Mr. Hickman stated that developments in the Fourth District confirmed the improved tone of business activity reported rather generally around the table this morning. The insured unemployment rate in the Fourth District at the end of April, after seasonal adjustment, stood at its lowest point in the current recovery, and for the first time in this recovery did not exceed the national average.

Steel production had advanced to high levels both locally and nationally, although the advance had moderated in recent weeks. Indications from the District suggested some leveling in production and orders, while shipments were still rising. Regardless of whether the labor contract was reopened, industry sources expected a decline in output in the third quarter, reflecting hedge-buying that had already taken place.

Countrywide, the average daily rate of new car sales in April exceeded the 1955 rate for the first time since January, and new car inventories were in good control. Auto production was expected to continue to increase moderately and to approximate 2 million cars for the second quarter.

Fourth District banks had been under little reserve pressure, and had expanded earning assets more this year than in other recent years. The banks were competing vigorously for the less liquid types of assets, including consumer loans, mortgage loans, municipal securities, and longer term Governments and business loans. They seemed to be surrendering liquidity to obtain higher yields.

There was increasing evidence of deterioration in the quality of credit. Reports from large national life insurance companies and the results of a recent survey of mortgage lending in the Fourth District revealed that loanable funds were in plentiful supply, that lenders were having difficulty in employing them, that maturities were being lengthened and downpayments being reduced, and that quality was being sacrificed, with loans in excess of market values in some cases. Moreover, the quality of directly placed corporate securities was reported to be deteriorating. Rates were being maintained at the expense of lower quality.

These developments suggested to Mr. Hickman that the deterioration in the quality of credit should be placed alongside the adverse balance of payments as a major factor to be considered in formulating monetary policy. The balance of payments figures for April and the recent behavior of the foreign exchange markets were disturbing. Recent monetary ease had encouraged foreign borrowers to enter U.S. capital markets, with a resulting outflow of long-term funds, and had also encouraged short-term funds to flow out of this country. In particular, financial institutions in the U.S. were placing large amounts of funds in Canadian long-term issues. Canadian borrowers, anticipating these flows, were putting pressure on forward rates, thus further encouraging the flow of short-term funds to Canada. The lowering of the Canadian discount rate yesterday might help to check the short-term flow, but hardly the long-term flow.

Unemployment remained high after many months of monetary ease, Mr. Hickman continued, suggesting that further ease was not the solution to this problem. It seemed to him appropriate to face up to the possibility that further ease might induce structural imbalances, which in turn could bring about an economic reversal and higher unemployment. Thus, it was his recommendation that Federal Reserve policy should work toward reducing monetary ease. Such a shift, in his opinion, should be reflected in higher interest rates across the maturity spectrum. The Committee should work over the next four to six weeks toward a 91-day bill rate in the 3-1/4 per cent to 3-1/2 per cent range, permitting other rates to move to higher levels in response to market forces, after which the discount rate could be adjusted upward.

Mr. Hickman believed that a change in the current economic policy directive would be appropriate at this time. He suggested that it be revised to indicate that open market operations during the next three weeks should be conducted with a view to providing progressively less ease in the money and capital markets.

Mr. Bopp reported that economic activity had increased moderately in the Third District in recent weeks, but that the improvements were gradual and far from universal. Department store sales in the District had turned in the worst performance in the nation so far in 1963, having actually dropped below the 1962 totals for the first third of the year. Manufacturing output and construction awards had increased a bit, and unemployment rates had moved down in almost every labor market. Manufacturing employment had not yet recovered, however.

During the month of April, loans at reporting banks in the District increased by about the same amount as in the comparable period last year. Investments fell, whereas they had risen during the comparable period last year, and total bank credit increased by only a little over one-half of last year's expansion. Liquidity positions of the larger banks appeared to be weakening somewhat. There was little evidence, however, of any increase in pressure on reserve positions.

In Mr. Bopp's view, the improvement in business had not been so vigorous as to warrant any less ease in policy. Recent developments did not support the views of the more optimistic observers, but even if these more favorable expectations proved to be right the expansion in the economy was likely to fall quite short of producing a satisfactory rate of resource utilization. Accordingly, he would continue to push ease as far as it could safely go in order to stimulate the domestic economy.

The balance of payments still provided a limit to the degree of ease, Mr. Bopp added, and in view of this continuing problem he would go no further than to maintain existing policy. He was glad to see that the recent congestion in capital markets had been corrected, and he would hope that such a development could be prevented in the future by open market purchases in the longer sector of the market. He would not change the discount rate, and he would not change the directive except for technical correction.

Mr. Bryan reported that most recent economic indicators in the Sixth District were favorable. Although he could not offer statistical proof, he sensed a tendency for the economic improvement to accelerate. The national situation presented a picture of increased underlying general strength, with improved business prospects and greater confidence on the part of the business community.

In the meantime, Mr. Bryan noted, there had been a gradual trend toward a reduced level of free reserves, on average, but a rising trend in the active money supply, the total money supply, and other liquid assets, both in absolute terms and as a ratio of gross national product. The growth of required reserves against private deposits had quickened in the period from December 19 through April 24. While the general price level was stable, there had been a mild restlessness in some prices. There was an inventory situation that presented some problem, a prospective large Government deficit, and a serious balance of payments problem. Also, there was a good deal of evidence of speculation in noncommodity areas. It did not seem to him that more monetary ease was called for; if anything, he believed that a policy of somewhat less ease would be appropriate.

Mr. Bryan suggested that at this juncture one should be careful in following guidelines. He did not feel that the free reserve guideline was of much use at this particular time, and he was not sure that the total reserve guideline was a great deal more useful. In these circumstances, he found some difficulty in making a suggestion in terms of policy. Nevertheless, required reserves against private time and demand deposits were well above the so-called 3 per cent growth guideline, and total reserves were above the long-term trendline. Therefore, he saw little choice but to cut back on the amount of reserves being supplied. He would propose adjusting for seasonal movements--insofar as they could be determined--and placing a limit of 2 per cent, annual rate on the growth factor in required reserves. He would not change the discount rate at this time.

In a further comment relating to the balance of payments problem, Mr. Bryan recalled having made the point several times that he did not think this problem had been caused by monetary policy. He had recently examined the rates of monetary expansion for recent years in various countries of the world. Leaving aside certain countries that had experienced spectacular rates of increase, he found annual rates of expansion, from 1948 through 1962, such as 54.9 per cent for Japan, 35.2 per cent for France, 27.6 per cent for Germany, 25.5 per cent for Italy, and 9.9 per cent for Switzerland. The United States was at the bottom of the list with an annual rate of 2.5 per cent. While this did not settle the question by any means, it did give some hint that perhaps the monetary policy pursued in this country had not been the cause of the balance of payments problem. It also suggested that the remedy probably should not be sought fundamentally through monetary policy.

Mr. Shuford reported that during the first quarter of this year Eighth District economic activity showed some improvement over the fourth quarter of 1962, and according to preliminary indications there was some further gain during April. Employment had been increasing somewhat since December and was slightly higher in the first quarter of this year than in the fourth quarter of 1962. Industrial use of electric power had been increasing since November and registered a quarter-to-quarter gain. Department store sales and bank debits, however, had changed little since the fourth quarter of 1962, and business loans had declined slightly since late last year.

Turning to the national picture, Mr. Shuford noted that the strengthening of the economy appeared to have continued since the April 16 meeting of the Committee. Production, employment, and incomes appeared to be rising. Despite these favorable signs, however, the evidence was not yet conclusive that the upturn would continue. The economy had not yet moved to rates of resource utilization higher than prevailed during most of 1962. In several respects the events of recent months resembled those that had occurred in the early part of 1962, at which time there was a moderate rise in most of the measures of business activity. A portion of the improvement early this year and early last year could be attributed to the situation in the steel industry. The improvement in the early part of 1962 was followed by a plateau for the remainder of the year, and it seemed that the pattern thus far this year was quite similar.

Mr. Shuford said that he would not favor any change in monetary policy at this time. There had been some moderate increase in reserves. However, if one measured from December the increases in reserves and in the money supply both had been in the neighborhood of about 3 per cent, which perhaps was moderate and desirable. Personally, he felt that it would be well if increases continued at about this rate. The balance of payments presented a problem, one that had been worked with and lived with for some time. Monetary policy, of course, had a role to play, and under all the circumstances he felt it had played a rather significant role. If the Committee should conclude to move toward a firmer monetary policy out of consideration of the balance of payments problem, he would be inclined to feel that the move, at such time as it was made, should be a rather significant one. The time might come when it would be necessary to do this.

It did appear, Mr. Shuford added, that in several noncommodity areas there had been a deterioration in the quality of credit extended. However, he wondered what effect a firming of monetary policy aimed at those specific areas might have on the general economic improvement for which the System had been hoping. It seemed possible to him that such a move might have a generally depressing effect. For the time being, therefore, he believed the Committee should continue its current policy, which would call for no substantive change in the directive and no change in the discount rate.

Mr. Balderston commented that he liked to act decisively in terms of monetary policy. However, he did not see grounds clear enough to justify going further than modest action at this time. It seemed necessary to him to study the results of such action for clarity that he lacked at the present time. As to timing, he felt that with the large Treasury needs for funds this fall the Committee should not pass up any opportunity for experimentation, and one such opportunity would be available in about a week.

Mr. Balderston said he had also been considering another point referred to during today's discussion, namely, how the volume of savings might best be put to work. In 1959 the net amount of funds used by nonfinancial institutions was around $53 billion, of which bank credit accounted for only around $5 or $6 billion. In 1962 the corresponding figures were $58 billion and $19 billion. He was unable to disassociate from the total the portion that represented bank-created credit in excess of the real needs of the economy.

Mr. Balderston went on to say that, with the assistance of members of the staff who, incidentally, might not necessarily share his philosophy, he had prepared a statement in order to reduce his thinking to a form containing some identifiable benchmarks. He then read the following statement:

This statement setting forth my position deals with two main points:

(1) A national economic policy appropriate to the moment calls for "holding the line" on costs and prices.

(2) The contribution of monetary policy to holding the line is to insure that excess liquidity does not lead to:
  (a) Leakage abroad,
  (b) Speculative excesses,
  (c) Imprudent decision making.

What is the case for a national hold-the-line policy? Clearly the greater the ability of American firms to compete in foreign markets, the greater will be their exports; the greater their ability to compete in domestic markets, the smaller will be imports into this country. This process will tend to make U.S. firms more competitive and to increase the foreign exchange available to our country to pay for its spending, lending, and investing beyond its borders.

The same hold-the-line philosophy is needed to provide job opportunities. The very mechanization that has permitted our American firms to remain competitive with respect to manufactured goods has reduced the number of manufacturing workers by two million. These, together with the inexperienced and unskilled, must seek jobs in distribution and other service industries. But rising salaries have induced both mechanization and the self-service evident in super markets and automats. In consequence, it is increasingly difficult for youngsters to get employment. A hold-the-line policy comes none too soon to provide jobs in construction, retailing, and other service industries for the 1-1/3 million for whom additional jobs must be provided each year.

To help implement a national policy of holding the line on costs and prices, monetary policy should take into account the marginal impact of such policy upon liquidity. The System cannot do the entire national job alone, but such contribution as it can make is its responsibility alone.

While recognizing the need for liquidity to be sufficient to lubricate expansion, and for commercial banks to be able to meet constructive loan demand (with some of our resources still unused), there are hidden pitfalls to which this Committee should be alert. These seem to be of three kinds:

(1) Liquidity outside the commercial banks so plentiful as to induce the exporting abroad of capital funds, whether short or long.
(2) Liquidity so abetted by the creation of bank credit as to induce speculation in stocks, land, or inventories rather than use for constructive purposes.
(3) The creation of bank credit of such an amount that, when added to savings, it will induce lending institutions to make imprudent loans or investments.

The question is: how much liquidity is appropriate at present?

This leads to the subordinate question: what benchmarks can be found to indicate when liquidity is becoming too little or too great?

The clearest analogy I can think of is the task of regulating the depth of water when irrigating a field. Without enough, the crop will not be nourished; with too much, the field will be overly wet and excess water may be lost to neighboring farms.

What benchmarks are usable, even if precise indicators be unavailable? We need a range with identifiable lower and upper limits that will signal when policy should be modified. However important it is, at certain times, to identify a lower limit, I shall confine myself today to an effort to define, even crudely, the upper limit of the liquidity that is now appropriate.

Clearly there is no sharp line of demarcation and so, as other members of the Committee have done, I propose experimental action in an effort to identify how much is too much. The reason for experimentation is to use the responses of the member banks and of the market place to assist us in identifying the upper limit.

As soon as appropriate after the conclusion of the present Treasury financing, I would favor a policy of somewhat less ease and would reflect it in today's directive. I would implement this policy by a reduction in free reserves to a level under $200 million.

If the projections in the staff memorandum prove to be correct, few if any reserves are likely to be needed until the week ending May 29. In assessing from week to week the impact of the policy I propose, the following indicators are relevant:

(a) A 90-day bill rate and a Federal funds rate around the discount rate. At times, the bill rate might well exceed the discount rate.

(b) Total bank deposits expanding at a more moderate rate than at present so that banks will compete less aggressively for short-term funds to be invested at longer term. I would prefer, however, not to bring about a contraction of the active money supply, nor a sharp increase in the rate of deposit turnover. Under my proposal, the <u>total</u> of required reserves supporting private deposits, currently projected to expand at a 3 per cent annual rate, would increase at some lesser rate than at present, but not at a rate so low as to cause the reserves behind private <u>demand</u> deposits to decline. These reserve indicators can be watched conveniently by reference to the two charts regularly appended to the reserve projection memorandum.

(c) Expansion of bank earning assets at a more moderate rate without forcing the net disinvestment by banks of their securities in order to accommodate legitimate loan demand but with less incentive to seek out marginal speculative risks or longer term risks. The expansion rate would permit a further increase in bank holdings of securities to the extent that banks acquire real savings and also permit money supply growth in keeping with the transactions needs of the economy.

Chairman Martin commented that at a certain point the formulation of monetary policy necessarily becomes a matter of judgment. One must weigh all of the available statistics and then reach conclusions on a judgment basis. Over the past several months, he noted, the Committee had been divided in the area of judgment, and there were evidences in today's discussion of the part that this factor must play. It should also be borne in mind, in appraising the interrelationship of monetary policy and economic forces, that although at times monetary policy may be of crucial importance, it is normally a residual factor.

The Chairman also mentioned that from the time of the Treasury-Federal Reserve accord to the period when the dollar became no longer invulnerable to outside pressure, which he would place in 1957 or 1958, there had been a movement toward greater stability of interest rates, to the benefit of everyone. Slight movements in either direction had come to have more impact, and he hoped it would be possible to keep interest rate moves within a relatively small range.

He happened to think, Chairman Martin continued, that the move made by the Committee last December toward slightly less ease had been quite important from the standpoint of the balance of payments and also the domestic economy. He knew, for example, that several large investment trusts bought securities following the Committee action in December that they would not have touched before that time because they were apprehensive that the Federal Reserve was going to follow a policy of ease compounded on ease in attempting to stimulate the domestic economy. There is a point, the Chairman observed, at which further ease will not work toward economic stimulation. There is also the practical problem that in a free economy lower interest rates may help in picking up unsound credits, and in his opinion there had been a steady deterioration in the quality of credit. He would be willing to accept that development if it were necessary in order to foster economic growth, but in his opinion the point at which easy money would further stimulate the economy had long since passed. This was the critical question: Whether easy money was now working in reverse.

At the risk of being repetitious, the Chairman continued, he remained of the belief that the balance of payments problem and the domestic economic problem were not separable. It seemed to him, also, that it should be recognized that the Federal Reserve was not going to make the domestic economy--or break it--by taking certain actions. The System should accept the indicators, as it saw them, and pursue a flexible course of action. For a time he had felt that the Open Market Committee was tending to get frozen into a pattern, although on the whole he thought monetary policy had been operating well. Monetary policy probably could take some credit--how much he did not pretend to know--for developments during the past several months.

As he saw it, Chairman Martin said, the balance of payments problem was growing worse. He had referred frequently to the possibility of a crisis, and he still felt that way. He did not think the situation was yet at a crisis juncture, but rather that it was tending in that direction, and in such circumstances the posture of the Federal Reserve System was most important. As indicated by Mr. Young's remarks and recent reports from other sources, monetary policy was under fire from observers abroad. There were criticisms that nothing significant was being done out of regard to the balance of payments. From that standpoint, it would perhaps be desirable if the Committee could make some decisive move. In his opinion, however, such a move was not feasible unless monetary policy had been trending for some time in a particular direction.

Chairman Martin then said that on the basis of today's discussion it appeared that the period following the conclusion of the current Treasury activity in the market would be as good a time as any to move toward slightly less easy monetary conditions. Here he was talking just about pulling a little on a rope that was already very loose. He was not talking about anything very dramatic. It might be, of course, that the Committee would decide later that this was not the direction in which it should have moved, and it might want to pull back. If the Committee waited too long, however, it might have to deal with an active problem of inflationary pressures. In his opinion, there was already a good bit of pressure in some areas that could build up rapidly. If one waited until after the resulting price movements actually occurred, he might wonder why he had not done something about it before. It would be too late at that juncture. Far from stimulating the economy, such inflationary pressures might well undermine the existing level of activity and lead to a decline in employment.

Personally, the Chairman continued, he would like to see the Committee move in the direction of slightly less ease, beginning about May 15. It was difficult for him to believe that experimentation in such direction could affect the economy adversely unless the current improvement that had been discussed at this meeting was so fragile that it could not continue in any event. If this was the case, he doubted whether monetary policy could turn the tide.

Chairman Martin then proposed placing before the Committee as a basis for decision a current economic policy directive that would call for operations with a view to achieving slightly less easy monetary conditions following the conclusion of the current Treasury refinancing.

There followed certain suggestions as to how such a directive might appropriately be worded, and it was noted that a draft of directive had been prepared by the staff for the Committee's consideration in the event the discussion at this meeting suggested the possibility of a decision to move in the direction of slightly less ease. The draft directive was read to the Committee and copies were distributed, following which certain minor modifications of the language were suggested.

It was pointed out, in this connection, that the draft directive was phrased in terms of achieving a slightly greater degree of firmness in the money market than had prevailed in recent weeks, and question was raised whether it might not be preferable to refer to a slightly lesser degree of ease since current monetary policy was characterized by a condition of ease. The discussion of this question brought out, however, that the policy directives issued at recent meetings had referred to a degree of firmness, as related to the money market, which suggested that in the interest of consistency and for comparative purposes there was something to be said for continuing the same terms of reference. It was the consensus that the theory of consistency recommended itself.

Chairman Martin then suggested that a vote be taken on the proposed policy directive, in form reflecting the minor modifications that had been mentioned.

> 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 moderate growth in bank credit, while putting increased emphasis on money market conditions that would contribute to an improvement in the capital account of the U.S. balance of payments. This policy takes into consideration the continuing adverse balance of payments position and its cumulative effects and the improved domestic business outlook, as well as the increases in bank credit, money supply, and the reserve base in recent months. At the same time, however, it recognizes the continuing underutilization of resources.

To implement this policy, System open market operations following the conclusion of the Treasury refunding operation shall be conducted with a view to achieving a slightly greater degree of firmness in the money market than has prevailed in recent weeks, while accommodating moderate reserve expansion.

> Votes for this action: Messrs. Martin, Hayes, Balderston, Irons, King, and Shepardson. Votes against this action: Messrs. Bopp, Clay, Mitchell, Robertson, and Scanlon.

It was agreed that the next meeting of the Open Market Committee would be held on Tuesday, May 28, 1963.

Mr. Hayes noted, as a matter of information, that plans were under way, at the request of the Chairman of the House Banking and Currency Committee, for a visit to the Federal Reserve Bank of New York by the members of the Committee in the latter part of June. The visit was to include, among other things, an explanation of the type of operations conducted by the Trading Desk.

The meeting then adjourned.

Ralph A. Young

Secretary