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, June 18, 1963, at 9:30 a.m.

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

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

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

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hexter, Assistant General Counsel
Mr. Noyes, Economist
Messrs. Baughman, Furth, Garvy, Green, 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

Messrs. Latham, Hilkert, and Hemmings, First Vice Presidents of the Federal Reserve Banks of Boston, Philadelphia, and San Francisco, respectively

Messrs. Mann, Taylor, Jones, Parsons, and Grove, Vice Presidents of the Federal Reserve Banks of Cleveland, Atlanta, St. Louis, Minneapolis, and San Francisco, respectively
Mr. Parthemos, Assistant Vice President, Federal Reserve Bank of Richmond
Mr. Cooper, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Eisenmenger, Acting Director of Research, Federal Reserve Bank of Boston

There had been distributed preliminary and revised drafts of minutes of the meeting of the Federal Open Market Committee held on May 28, 1963. The revised draft incorporated amendments to the Committee's Guidelines for System Foreign Currency Operations reflecting the following actions that had been taken by the Committee at the May 28 meeting: (1) adoption of a working rule that, in the absence of exceptional circumstances, drawings under a reciprocal currency arrangement should be fully liquidated within twelve months; and (2) authorization to the Federal Reserve Bank of New York to utilize its holdings of a currency for the purpose of settling commitments denominated in other currencies, up to a combined total of $50 million equivalent. The revised draft also incorporated an appropriate amendment to the continuing authority directive to the New York Reserve Bank on foreign currency operations covering the second of these two Committee actions. The revised draft of minutes further incorporated an amendment to the Guidelines flowing from action taken by the Committee at its meeting on March 5, 1963, authorizing the New York Reserve Bank to purchase

specified currencies through forward transactions up to a combined total of $25 million equivalent for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements. This action was reflected at the time in the continuing authority directive but not in the Guidelines.

It was noted that approval by the Committee of the minutes of the May 28 meeting would serve to ratify the foregoing amendments to the Guidelines and to the continuing authority directive. It would follow that reference to these amendments would be included in the entry for the record of policy actions of the Open Market Committee covering the meeting of the Committee on May 28, 1963.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 28, 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 May 28 through June 12, 1963, together with a supplementary report covering the period June 13 through June 17, 1963. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Coombs summarized current and prospective developments with respect to the

U. S. gold stock along with conditions in the London gold market.

Turning to System foreign currency operations, he noted that the System had completed repayment of its Swiss franc drawing under the swap arrangement with the Swiss National Bank through transactions conforming to the procedure authorized by the Committee at its meeting on May 28, 1963. He also noted that negotiations had been completed for liquidation on June 20, 1963, of the drawing of $16 million of Swiss francs that remained outstanding under the swap arrangement with the Bank for International Settlements.

In further comments, Mr. Coombs said that announcement of the increase from $50 million to $500 million in the swap facility with the Bank of England, pursuant to the Committee's authorization at the meeting on May 28, had been generally well received by central banks. However, certain foreign Treasury officials apparently were continuing to press to bring the System's swap arrangements under some form of international surveillance. He had taken the position, Mr. Coombs said, that drawings against swap facilities were purely a matter of bilateral relationships and that the integrity of the Federal Reserve System was an adequate safeguard against the abuse of such swap facilities. Further, the Federal Reserve System had published two articles at approximately six-month intervals giving a full story of System swap arrangements and operations thereunder. He thought, however, that it might be useful on the occasion of the monthly meetings of the

Bank for International Settlements at Basle to advise the participants confidentially on Federal Reserve drawings and repayments under such arrangements, subject to prior concurrence by the other central banks that were parties to the respective swap agreements. Such a procedure would serve to dispel rumors that might otherwise be circulated as to the extent of Federal Reserve commitments in various currencies.

It was suggested in the alternative that the purpose might be served by comments in the course of conversations with central bankers attending the meetings, as and when that seemed desirable, rather than to put the matter within the framework of a regular reporting basis. Mr. Coombs agreed that the alternative procedure would serve the purpose, adding that during the course of the monthly meetings he was in conversation with representatives of the central banks attending the meetings. It was the consensus that the alternative procedure would not be inappropriate, assuming that information concerning drawings and repayments under System swap arrangements would not be divulged except after clearance with the central banks that were parties to the particular reciprocal currency agreements.

Proceeding with his review of System foreign currency operations, Mr. Coombs referred to the recent strengthening of the dollar rate against the Netherlands guilder, which had resulted in a termination of System operations in that area. He also described prospective developments that might afford an opportunity for repayment of part of the

System's drawings of guilders under its swap arrangement with the Netherlands Bank.

Mr. Coombs noted that the continued strength of the German mark had resulted in drawings by the System of $100 million equivalent of marks in four instalments under the swap arrangement with the German Federal Bank, and disbursement of $90 million equivalent of the marks thus drawn. It was Mr. Coombs' view, for reasons stated, that the System should continue its operations in support of the dollar against the mark, drawing if necessary the full $150 million equivalent of marks available under the swap arrangement with the German Federal Bank. Under certain circumstances, a case might even be made for negotiating an increase in the swap facility, but on balance he felt that the System would be well advised to limit its drawings to no more than $150 million and invite the Treasury to deal with any further flow of funds into Germany. Further, if no reversal of the present situation was seen over the next three months, he was inclined to feel that the System should suggest to the Treasury and the German Federal Bank the possibility of funding the System's swap drawings indirectly through additional issues by the Treasury of bonds denominated in German marks. An alternative would be purchases of gold by the German Federal Bank.

In further explanation of his views in this regard, Mr. Coombs said that if the System should run through the remaining $60 million of marks available under the swap arrangement with the German Federal Bank and a substantial speculative flow of money into Germany developed, a

case possibly could be made for increasing the swap facility. However, System operations were intended to deal with financial flows that were expected to be reversible, and as yet there was no sign of a turning of the tide of flows into Germany. Therefore, if the System exhausted the remaining $60 million equivalent of German marks available under the swap facility, it might still be faced with the possibility of continuing market operations in support of the dollar for an indeterminate length of time. In such a situation, it might be well to call a halt to System operations.

Mr. Coombs concluded his comments with remarks on the recent weakening of the Italian lira and prospective developments in that regard.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period May 28 through June 17, 1963, were approved, ratified, and confirmed.

Mr. Coombs pointed out that the $250 million swap arrangement with the Bank of Canada would mature June 26, the $50 million swap arrangement with the Bank of Sweden would mature July 17, and the swap arrangements with the Bank of Italy, the Swiss National Bank, and the Bank for International Settlements, in the amounts of $150 million, $100 million, and $100 million, respectively, would all mature July 18, 1963. He recommended renewal of these swap arrangements, each for a further period of three months.

Renewal of the aforementioned swap arrangements, as recommended by Mr. Coombs, was approved unanimously.

Mr. Coombs noted that a System drawing of $25 million equivalent of guilders under the swap arrangement with the Netherlands Bank would mature July 11, 1963, and he recommended renewal of the drawing for a further three months if that should prove necessary.

Renewal of the drawing if necessary, as recommended by Mr. Coombs, was noted without objection.

Mr. Coombs pointed out that the Bank of England's drawing of $25 million under its swap arrangement with the Federal Reserve System would mature July 16, 1963. If the Bank of England should so request, he recommended that a three-month renewal of the drawing be granted.

The granting of a renewal of the drawing, if requested by the Bank of England, was noted without objection.

This concluded the consideration of System foreign currency operations and related matters.

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 May 27 through June 12, 1963, and a supplementary report covering the period June 13 through June 17, 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 continued steadily firm in the period since the last meeting of the Committee. There were only slight further price and yield adjustments to the recent shift in System policy while, during the course of the period, there was an astonishingly enthusiastic reception for the Treasury's sale of 4 per cent bonds of 1970.

Turning first to the sale of the 4 per cent bonds, it may be premature to attempt to draw any firm conclusions about this operation, but one or two points do seem to emerge. Clearly, the $100,000 figure for subscriptions to be allotted in full was set at too high a level; moreover, by indicating this full allotment figure in advance of accepting subscriptions, some sizable speculative interest was encouraged. More fundamentally, the episode illustrates the great difficulty in setting price and other terms on Treasury offerings when the market is in a period of transition. In this case, the market's shift toward expectations of somewhat higher rates had for the time being about run its course--although it seemed at the time when the Treasury had to set its terms that the underlying atmosphere was still very cautious and called for terms that would be regarded as attractive by investors.

As regards System operations and the money market, the recent period has afforded an excellent example of the uncertainties that lurk behind bank reserve statistics and the projections of such data. Once again, market tone proved to be the most reliable part of our "guidance system." In terms of actual reserves--or rather, in terms of current estimates of actual reserves--free reserves were somewhat lower in the past few weeks than in the preceding three-week interval, but the money market had, if anything, a slightly easier consistency. Member bank borrowings averaged a little lower, and while Federal funds traded at 3 per cent most of the time, there were fewer occasions on which really substantial reserve needs remained to be satisfied at the discount window.

These developments were, in good part, a reflection of a shift in basic reserve availability toward the money center banks. The New York City banks, in particular, had a much smaller basic reserve deficiency than in the previous period, and accordingly were able to reduce both their net purchases of Federal funds and their borrowings from the Reserve Bank. Thus, while the countrywide supply of Federal funds may have been somewhat lower than in the previous three weeks, the demand was also appreciably less, and resulted on balance in a slightly more comfortable tone in the money market.

Apart from these geographic shifts in basic reserve availability, which rather complicated the interpretation of

the significance of given reserve levels, System operations were further complicated during the recent period by an extraordinarily persistent series of "misses" in the day-to-day reserve projections. Sizable misses are of course not unusual, but one can often depend on a rough balancing out from day to day between over-estimates and under-estimates of the various reserve factors. In the recent period, however, there was a strong tendency for actual reserve levels to fall short of the projections, particularly the projections of float and the Treasury balance at the Reserve Banks. As regards the Treasury balance, there has been some tendency for daily expenditures to fall short of estimates and for revenues to run higher. As for the misbehavior of float, we have no ready explanation but some work is being done to re-examine past patterns to see if more reliable projections can be developed.

Treasury bill rates, after moving upward following the policy shift in the latter half of May, have hovered around 3 per cent in the case of the 3-month issue, while the 6-month bill has moved around 3.08 per cent.

In the Treasury bond market, there have been few developments of any significance, apart from the activity surrounding the new 4's. Over the past three weeks prices of most issues have been down somewhat, with declines mainly in the maturities close to the new 1970 issue.

The limited extent of the decline reflected in part the favorable technical position of the market following the heavy purchases of bonds by the Treasury in the latter part of May as it grappled with the problem of the debt ceiling. At the moment at least, the bond market atmosphere seems fairly steady and more confident than it was three weeks ago, when the market was still adjusting to the lower level of reserve availability.

The situation in the corporate and municipal markets has been mixed. In the corporate area there has been a continuing tug of war, with underwriters bidding strongly for a limited supply of new issues and then being content to distribute the bonds slowly to rather reluctant investors. Rates on new and outstanding issues have remained about unchanged. In the tax-exempt market, on the other hand, the rate trend has been upward. The calendar of new issues has remained large, and dealer inventories have been kept from rising only by virtue of continuing price concessions.

The reserve projections for the three weeks ahead indicate that unusually large amounts of reserves will be needed. The New York projections suggest a need of over $700 million, while

> the Board staff estimates indicate a need of about $1.2 billion. And both sets of estimates have recently been on the low side of actual results. Under the circumstances, I should like to recommend that the limit on changes in the Account over the next three weeks be raised from $1 billion to $1.5 billion. I hope it will not be necessary to operate on that scale. But it would be well to be prepared if we should have to do so.

During discussion based on Mr. Stone's report, it was noted that projected reserve drains exceeded $1 billion in the three weeks ending July 10, with an indication that part of the drain would reflect an increase in U. S. Government deposits at the Federal Reserve Banks. Question was raised whether it would not be reasonable for the Treasury to leave the Government deposits at a somewhat lower level, thus relieving the pressure on the System to provide reserves. Mr. Stone commented that System-Treasury discussions had resulted in general agreement on the desirability of keeping Treasury balances at the Reserve Banks rather constant at a level of about $900 million. In the preceding statement week, the balances had fallen relatively below, but they had already been restored to around the $900 million level, thus resulting in a reserve drain.

Mr. Mitchell referred to Mr. Stone's comment that in the past period the tone of the market had once again proved to be the most reliable part of the Desk's "guidance system." He inquired whether the Manager felt that he was operating in conformity with the Committee's directive in following the tone of the market as a primary guide. Mr. Stone pointed out that the Committee's instructions called for

maintaining about the same degree of money market firmness. He regarded the reserve projections as one part of the apparatus employed in measuring the tone and feel of the market, not only in terms of what was happening at the moment but in days ahead. In that sense, the reserve projections entered into the operations of the Desk. There had been a number of occasions on which the estimates pointed to free reserve levels over $200 million. If the Desk had been guided by those estimates alone, presumably it would not have undertaken any open market operations, but the market itself suggested that those figures were not accurate. The market acted as if there were fewer reserves around. Therefore, despite the estimates the Desk went in and bought bills rather heavily. Asked whether it was fair to infer that the Desk had operated according to the tone and feel of the market and not according to the reserve projections, Mr. Stone replied that these factors could not be separated so sharply. The Desk operated primarily on the basis of tone and feel of the market, but the reserve estimates were used as an indication of the market tone that the Desk was likely to be confronted with three or four days hence. If the reserve projections had given the appearance of being more accurate, there might have been marginal changes in the Desk's operations. On some days the Desk might have bought a little less or sold a little more, but the general thrust of the Desk's operations would have been about the same.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period May 28 through June 17, 1963, were approved, ratified, and confirmed.

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

Most of the recent information on the performance of the economy suggests that the broad observation we have used so often in the last two years may again be appropriate. The economy is generally expanding, with resources available for further expansion.

Unemployment, especially among teen-agers, has continued to creep upward. Despite the high level of auto sales, the performance of retail trade as a whole has been a little disappointing--in that there has been practically no further advance since last November. Concern is expressed that in the absence of a tax cut the current upward thrust may falter when the stimulus recently provided by steel inventory accumulation is reversed.

On the other hand, some sectors are more active than was generally anticipated. Construction activity, especially the construction of multi-family private residences, has held up better than many expected, and most recently has been rising.

If the prospects for capital investment were any stronger, they might well be a cause for concern rather than comfort. Plant and equipment spending in the second half implied by the latest Commerce-SEC survey would be up 7 per cent from the 1962 level for the same period. A higher rate would raise a question as to whether capital spending plans were realistic in relation to recent developments in final demand and, therefore, likely to be sustained.

Furthermore, it is increasingly difficult to summarize the total pattern of price developments as one of price stability. Wholesale prices were up in May, and the prospects seem to be that these prices will increase further--perhaps by a larger amount--in June. It seems to me that it would be wrong to describe recent price developments in the aggregate as alarming or even inflationary, but at the same time one

would be reluctant to see any more upward price pressure than has prevailed.

While we may all wish devoutly for a higher rate of economic activity--and a lower level of unemployment--it is hard to see how developments of recent weeks could realistically have been more favorable to the achievement of these goals. The activity mix certainly has not been ideal--it never is. In this case we might have liked a little larger volume of final purchases by consumers and a little less buying of steel for inventory. But the over-all rate of progress seems to have been about as large as the economy could handle without raising more questions than it answered for the ultimate objective of sustained expansion.

It now appears that real GNP increased at an annual rate of about 4-1/2 to 5 per cent during the first half of 1963. Without suggesting that we can be at all complacent with respect to the future, it does appear that this rate is as sustainable, and perhaps more sustainable, than either a higher or lower rate would have been. At least one can say that any sizeable additions over and above the increase in total demand that actually occurred would have had to be fortunately selective not to have created problems and that any considerable shortfall would have had to be similarly well placed if it were not to raise questions as to the future.

My own judgment is that a continuation of about the recent rate of expansion, rather than either an acceleration or deceleration, is the optimum to which policy should be directed. As I said before, one would hope that the composition might shift in several ways--and certainly that we might achieve lower rates of unemployment--but neither a faster nor a slower over-all pace of expansion would seem likely to contribute to the achievement of our objective in the longer run.

If one accepts this broad objective, what sort of a monetary policy would contribute to its achievement? My guess is that it might be necessary to let credit markets ease a little in response to the usual summer doldrums, accentuated this year by steel inventory adjustment, which now looks as if it might lie immediately ahead of us. Then, if Government and business spending plans materialize in the early fall, in the magnitudes now foreseen, some lessening of ease at that time would be both a natural and desirable result of rising credit demand.

For the time being, since the economy shows no evident signs of a significant change of pace, neither a substantially

tighter or easier policy would be called for to maintain the present rate of progress. The case for a change, if any, would seem to rest primarily on other than domestic considerations.

Mr. Koch presented the following statement on financial developments:

It is still too early to trace satisfactorily the effects of the recent slight further lessening in monetary ease on the course of bank credit and the money supply. Thus far, the effects have been concentrated mainly in the money market, although free reserves have been somewhat lower and borrowings larger at country as well as city banks, suggesting a spreading of less easy reserve positions throughout the banking system.

In the money market, short-term interest rates have risen about 10 basis points or so, mainly in response to reduced bank reserve availability. Free reserves since mid-May have averaged $100 to $150 million less than earlier. The Federal funds rate has continued to bump against the 3 per cent discount rate, and New York commercial bank lending rates to Government security dealers have ranged between 3-1/4 and 3-1/2 per cent.

At the same time, actual required reserves behind private deposits have inched up relative to the guideline since May 22, after having declined in the preceding month. In the next couple of weeks they may drop sharply again, for the Treasury is expected to accumulate a very large end-of-fiscal year balance, thus temporarily tending to drain off private deposits and reduce required reserves behind such deposits. During this period, the Account Management might well try to provide as many reserves as possible, within its bill rate and money market constraints, to cover the sharp rise in Treasury deposits, so that private deposits do not fall so far below the guideline that it would be difficult to recoup later.

As for bank credit and money, both continue to show moderate movements. Although total loans and investments rose again in May and early June, after their sharp April contraction, the rise has been less pronounced than it was in either the first quarter of this year or in the autumn of last year.

The money supply showed no change in May but probably rose a little in early June. Since January, the money supply

has grown at a seasonally adjusted annual rate of about 2 per cent. Moreover, the demand deposit component of the money supply has shown no change over this period, all of the growth in the total being due to a rise in currency in circulation. Interestingly enough, in our guideline projections we allow for growth in time and savings deposits but not for growth in currency in circulation.

Time and savings deposit growth at commercial banks in May and early June was probably at a seasonally adjusted annual rate of about 13 to 14 per cent, as compared with 17 to 18 per cent earlier. The inflow of savings at saving and loan associations also slackened in April and May, but that at mutual savings banks continued large.

The capital markets reacted to the modest recent change in monetary policy with relative indifference. Municipal yields--a special case--rose sharply, but yields on new high-grade corporate issues actually declined a few basis points. Yields on longer term U. S. Government notes and bonds had steadied before the Treasury's announcement on June 6 of its new intermediate-term cash financing, the public response to which can only be termed spectacular.

As for the future, the third quarter is likely to provide seasonally light corporate and municipal calendars of new public issues, although private placements may continue large. Federal Government borrowing in the last half of the year may be considerably less than anticipated earlier. Cash receipts have been larger than expectations and expenditures are lower. New financing in the months ahead may well be only a little higher than during the second half of 1962. This may have a bullish effect on bond prices when it is fully realized by the market

Finally, I should like to make two comments on the regular staff reserve memorandum that is distributed before each meeting. First, we have made another change in the base period in recognition of the shift in policy adopted at the May 7 meeting. Both because the change in policy was not effective until after the Treasury refinancing was completed about a week later and for technical reasons explained in the memorandum, we are now considering the week ending May 22 as the zero base from which to compute cumulative changes of actual required reserves from the guideline.

We are continuing to include a 3 per cent annual growth trend in the guideline computation. The staff has considered the suggestion occasionally made that this growth allowance be reduced somewhat, perhaps to 2 per cent, but has decided against a change essentially for the following reason. With

actual required reserves behind time and savings deposits currently increasing at a seasonally adjusted annual rate of 13 to 14 per cent, a 3 per cent increase in required reserves behind total private deposits provides reserves to support less than a 1 per cent annual rate of increase in demand deposits. A 2 per cent increase in required reserves behind total deposits, assuming continuance of the current rate of growth of time deposits, would necessitate demand deposit contraction at an annual rate of about 1/2 of 1 per cent. Although it is no doubt true that some of the recent growth in time and savings deposits has provided essentially the same stimulus to spending as the growth in demand deposits, the staff did not consider it appropriate to use a guideline figure that implied demand deposit contraction.

Moreover, the new time and savings deposits of commercial banks, as well as those at mutual savings banks and shareholdings at saving and loan associations, appear to have more the characteristics of real savings rather than money. This is suggested by the lack of increase in the turnover of these deposits and shareholdings since their increased rate of growth began a year and a half ago. Personal time and savings deposits at commercial banks still apparently turn over about once every two years, and deposits at savings banks and shareholdings at saving and loan associations about once every four years. These turnover rates have been very stable at these low levels for many years.

Low and stable time deposit turnover rates do not, of course, tell us how much of the recent growth in these deposits has come from shifts out of demand deposits. Nor do they tell us how much of the recent growth represents, in essence, money rather than savings. They do suggest, however, that the new time deposits are not being used as transactions balances any more than the old ones were. The new time deposits could, of course, still have arisen as a result of shifts out of demand deposits, with the remaining demand deposits turning over more rapidly. According to our demand deposit turnover figures, this is apparently what has taken place, to some extent at least. The relevance of all this for monetary policy is that a somewhat greater degree of restraint on the narrowly defined money supply is probably needed now than earlier in order to achieve the same broad economic objectives.

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

> The U. S. payments position remains unfavorable. In May, the deficit, tentatively estimated at $330 million, was somewhat higher than in April or in the average of the first quarter. The preliminary and fragmentary weekly figures for the first two weeks of June indicate a similar deficit this month.
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> Detailed data are available only through April, and some of those are preliminary or fragmentary. But they permit some idea of what has been happening.
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> The cumulative deficit in those four months was about $1,050 million. A surplus on trade and nonmilitary services of about $2,250 million was offset by net Government expenditures for foreign aid and defense of perhaps $1,850 million and direct investments of perhaps $500 million, leaving a combined deficit on these accounts perhaps as small as $100 million. But in addition we know of recorded movements of financial capital, including $550 million of net acquisition of portfolio securities, primarily foreign bond issues, and $150 million net extension of bank-reported credits. This leaves perhaps $250 million unaccounted for, including presumably classified expenditures abroad of some U. S. Government agencies and under-reporting of imports of goods and services as well as unreported movements of private capital.
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> This year, as in most previous years, the U. S. deficit thus reflected, as the IMF paper on the U. S. payments balance puts it, an exchange of liquidity for foreign assets. But this year some of these exchanges involved assets of rather similar character. On two recent occasions, for instance, sums flowing into European countries as proceeds from foreign government bonds acquired by U. S. residents have, for all practical purposes, been reinvested in U. S. bonds issued by the Treasury in the currency of the country involved--with only two differences. From the U. S. payments point of view, it is probably unfavorable that the foreign bonds were acquired by U. S. private investors but the Treasury bonds by foreign monetary authorities; it is favorable, on the other hand, that the U. S. bonds bear lower interest rates than the foreign bonds.
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> Abroad, the recovery in Europe from the winter set-back seems to continue. Less welcome from the point of view of the U. S. payments balance is the resumption of heavy flows

of private capital, particularly into Germany. In the field of foreign policy, two developments may have an impact on flows of funds from the United States. The first is the tendency of foreign countries to take restrictive, or cease expansionary, policies; the latest example is the increase in the discount rate of the Bank of Sweden. The second is their effort to find ways to restrict the inflow of U. S. investment capital, insofar as it involves control over domestic industries. The Canadian budget promises a tax reform pointing in that direction, and France has finally induced the European Economic Community to look into the alleged danger of "alienation" of European enterprises to U. S. capital.

Last time, the understanding way was mentioned in which the IMF delegation treated the U. S. payments problem. This time, the BIS may be added to the list. The annual report of the BIS has been widely quoted and misunderstood. As I read it, the essence of its views on the subject is contained in the following sentences:

> "Contributions to equilibrium are needed from a reduction in net capital exports and in government dollar expenditures abroad. The authorities have indicated that a tighter monetary policy will be feasible as the economy expands with the aim of reducing capital exports and attracting capital imports. Such a policy would have to be directed mainly to longer term investment funds, as short-term interest differentials have largely been eliminated and as substantial attraction of liquid funds from London would not be desirable."

At this point the Chairman called for the usual go-around of comments and views on economic developments and monetary policy beginning with Mr. Hayes, who presented the following statement:

The domestic economy appears to have expanded further in May. Industrial production and residential construction continued to show strength, and retail sales recovered from what turned out to be a very small April dip. Manufacturers' sales expectations have taken a sharp turn for the better, while business plans for spending in the second half of 1963 seem to be a bit stronger. These various factors provide a

reasonable basis for expecting continued expansion during the rest of the year. On the other hand, the surge of teen-agers into the labor force kept unemployment high in May and may cause further deterioration this month.

Commercial bank credit expanded strongly in May, but weekly data suggest some lessening of the pace of advance in late May and early June. So far, bank credit components have not reflected an adjustment to the firmer money market conditions of the past month, nor do they point to any noticeable revision in anticipations regarding the future course of rates. Thus, the banks have been investing even more heavily than in the previous month in real estate loans, consumer loans, and other securities, while business loans have been unusually weak. Also, time deposits have continued to increase rapidly while the money supply has risen very little.

Recent balance of payments developments have been quite disappointing, with the May deficit of around $300 million exceeding the heavy April deficit. To a considerable extent this high May figure (as well as the large 5-month aggregate) reflects an upsurge of foreign security placements, primarily by Canadian borrowers. There may be some diminution of long-term borrowings and direct investment in the months ahead; but I think we must face the fact that the continuance of an over-all deficit at anything like its present level constitutes a threat of the first magnitude to the dollar despite the recent calm atmosphere in the exchange and gold markets.

While only $202 million of the 5-month deficit of about $1-1/4 billion was settled in gold, we can hardly expect such a low proportion to persist in the future. For one thing, there has been a substantial rise in foreign private dollar holdings so far this year, but this appears to be mainly the result of an increase in the liabilities of American banks to the branches abroad, probably reflecting Euro-dollar market activity. Also a sizable part of the deficit has been financed through Treasury borrowings abroad, and there is a limit to the willingness of the European countries to undertake such financing, especially in the absence of convincing evidence that the deficit is being gradually reduced. I hope that the members of the Committee have had an opportunity to read Mr. Coombs' forceful memorandum on the "Present Position of the Dollar," expressing the judgment that we have reached a critical phase and that the dollar has become vulnerable to a break in confidence which might occur almost without warning. The thinking of the European monetary authorities is pretty accurately reflected in the Annual Report just released by the Bank for International Settlements,

which strongly urges higher interest rates in this country and incidentally holds out no hope that our problem will be eased by further interest rate declines in Europe.

In considering appropriate future policy actions, we must of course give careful attention to the timing of the Treasury's program of financing over the next few months. It is quite clear that the Treasury's calendar is crowded and that there will be only a few brief periods when we will have reasonable freedom to act. The first and most satisfactory of these periods is from about Thursday of this week, June 20, when payment for the surprisingly successful new 4 per cent bonds will be made, until the week of July 8, when the July one-year bill will probably be auctioned. With new cash financing and announcement of the August refunding expected later in July, it would appear that unless we move in the near future we shall be "locked in" until September, and even that month may be pre-empted, since another advance refunding may be carried out at that time.

As I indicated at the last meeting, I believe that we made the right move in open market policy on May 7 and that the resulting firmer tone in the money market has been widely accepted as appropriate to the country's international and domestic outlook. In my judgment it has had a wholesome effect in causing growing expectation of a subsequent discount rate increase while at the same time demonstrating our cautious solicitude for the state of the domestic economy. After six weeks of this somewhat greater degree of firmness, I think we can well afford to move a little further on this road in preparation for discount rate action. I would hope that we could get the 90-day bill rate above 3 per cent and keep it there; and in view of the continuing heavy corporate demand for bills and the relatively low level of dealer positions, this objective may well call for somewhat larger borrowings and somewhat lower free reserves than the average of the past three weeks. Free reserves might well have to drop below $100 million.

The directive might appropriately be changed slightly to reflect this modest additional move toward greater firmness in the money market following completion of the Treasury financing, and to place less emphasis on reserve expansion.

As for the discount rate, it seems to me clear that the time for decision is at hand. While it would be reassuring, before making our move, to have a more emphatic demonstration of strength in the domestic economy and a clearer picture in regard to the stimulative effects of the tax bill now in the

Ways and Means Committee, the continued gravity of the international payments position leaves us little choice, especially in the light of the Treasury's calendar, as I have already suggested. An increase of 1/2 per cent in the discount rate in the near future could be expected to serve two very important purposes: (1) to signal to foreign monetary authorities and to the world in general that the System is ready to use traditional tools of monetary policy to defend the international position of the dollar, and (2) to achieve a level of short-term market rates that should cause a substantial repatriation of short-term funds. At this juncture we would probably do well to try to hold down the impact of our action on long-term rates, because of the uncertainties in the domestic economy--even though at a later date we may conclude that our international problems call for an all-out defense affecting interest rates and credit availability throughout the maturity range. We might consider softening the impact of the discount rate move on long-term rate expectations by using longer maturities to the extent practicable when reserves must be provided, as they must in very considerable volume over the next few weeks, and perhaps by some use of swaps between long and short maturities.

Apart from even-keel considerations there is another reason why late June would seem to be a highly appropriate time for discount rate action. It is my understanding that the President will probably make a forceful speech on the entire balance of payments program early in July, with emphasis on the need for stronger Government action in several directions. This would help to make our own move both more acceptable and more effective. It seems to me that prior rather than subsequent action by the System is somewhat preferable from the standpoint of the System's posture of independence within the Government. As for foreign reactions, I am confident that the British and Canadian authorities would be sympathetic, even though it is conceivable they might find themselves under considerable pressure to make some rate adjustments of their own. In any case, it is the international financial position of all three countries, vis-a-vis the Continent, that is of crucial significance, and we should welcome any strengthening of this position. We have strong reason to believe that the Continental European central banks, which have long urged a tightening of credit policy by the Federal Reserve, would not frustrate such action by competitive tightening of their own credit policies. Incidentally, we also have some hope that

> the European central banks might be willing, at least temporarily, to restrain borrowing activities by their commercial banks in the Euro-dollar market to help minimize any upward effect on Euro-dollar rates of our own action.
>
> It would seem to me highly desirable that an increase in the discount rate be accompanied by a further relaxation of the interest rate ceilings imposed by Regulation Q. In particular, the 90-day ceiling, which is already decidedly restrictive, might well be increased to 3-1/2 per cent and the 6-month ceiling to 3-3/4 per cent. Action along these lines would give strong support toward our objectives in the area of short-term capital flows.

Mr. Irons reported that in the Eleventh District the component parts of the economy had shown mixed movements recently, with probably a little net improvement. There had been no significant change in the financial picture. Loans were up a bit, time and savings deposits showed a further advance, demand deposits were down somewhat, and investments were off a little. Total bank credit showed a slight decline. Demands of banks for funds, either through the Federal funds market or the discount window, were relatively unchanged. As for some time, District banks were net purchasers of Federal funds in the most recent period. Borrowings from the Reserve Bank ranged generally in the $5-$10 million area.

In summary, Mr. Irons said, the District showed little change in economic and financial factors, and there had been no noticeable change in general attitudes. Neither businessmen nor bankers were expecting a strong economic upsurge, but they were confident of the continuation of a good level of business activity.

Turning to monetary policy, Mr. Irons said he was inclined to feel that it would be desirable, with one possible exception, to maintain the same degree of money market firmness that had been maintained during the past three weeks. He was quite satisfied with market conditions and with the operations of the Desk during a period that had been rather difficult due to factors mentioned by the Account Manager. He was rather glad to see the three-month bill rate drop back to a level slightly below the discount rate. To repeat, he would consider it in order to maintain for the next three weeks the degree of firmness that had been achieved.

Mr. Irons went on to say that he had read the Coombs memorandum referred to by Mr. Hayes. His problem was a lack of personal knowledge of the exact situation in Europe with regard to the degree of confidence in the dollar. If a substantial loss of confidence in the dollar was imminent, or if there were other elements in the picture that would call for action on the discount rate, he would favor such action. This kind of move would have some shock element; perhaps, in fact, an increase to as high a rate as 4 per cent ought to be considered from that standpoint. The only reason that he saw for raising the discount rate at this time, however, would be the existence of a serious and almost imminent loss of confidence in the dollar about which something must be done. If this was actually the situation, he did not think the System should feel restricted from taking action even at a time when the Treasury was in the market,

because the threat externally would be more serious than the problem of the Treasury. To summarize, if the conditions that he had mentioned were imminent, firm action on the part of the System would be in order. If they were not imminent, he would favor continuing the monetary policy that had been in effect during the past three weeks.

Mr. Deming noted that employment in the Ninth District, which was weak early in the year due to weather conditions, rose more than seasonally in April and May, and apparently this stronger trend was continuing in June. The District had been running slightly below year-ago employment levels but probably would go ahead of them in June. Production had grown appreciably faster than employment, and the improvement was broadly based. In April the industrial power use index was 10 per cent ahead of the previous year, and almost 6 per cent ahead of January. Ore shipments had been relatively slow, partly because the Great Lakes opened up late and partly because stocks at mills were high. Agricultural prospects were excellent, with the moisture situation very good.

Respondents to the Reserve Bank's most recent survey of attitudes gave the most optimistic appraisal of the business outlook since April and May of last year. Seventy-four per cent saw improvement as probable or certain, and only 2 per cent saw a decline as likely. The balance, of course, foresaw continued stability.

As to District banking developments, loans were up more than

seasonally in May, with particular strength at country banks. Country bank loan-deposit ratios hit a postwar high in May, a point above the previous peak of May 1960. City bank loan-deposit ratios were still 5 points below the May 1960 peak, but they were 5 points above the December 1961 level.

As to monetary policy, Mr. Deming said he had gone through about the same thought processes as Mr. Irons and had come to about the same conclusions. It seemed to him that the Desk had done quite a good job during a rather difficult period, and he would like to maintain as nearly as possible the current degree of money market firmness. If the degree of international confidence in the dollar had reached as low a point as suggested by Mr. Coombs' memorandum and the comments of Mr. Hayes, the System probably should take some action of a dramatic and drastic nature. Personally, however, he was not completely convinced that such action was necessary at this particular time, and he would prefer not to change the discount rate now. If firm action was deemed to be required by the international situation, the usual considerations of even keel should not preclude the System from taking such action even during a period of Treasury financing. In other words, he would regard the open periods for monetary policy actions as broader and more extended under such conditions than would normally be the case. Absent a real dollar crisis, though, he would maintain monetary policy about as at present, with no change in the discount rate.

Mr. Scanlon said that although business indicators showed mixed signs, it was believed that business activity in the Seventh District would improve gradually through the second half of 1963 despite a probable sharp decline in steel output and a possible slowing in the auto industry. This view was shared generally by business economists in the District.

Local steel economists were now estimating that about 5 million tons of "excess" inventories would have been accumulated by the end of the second quarter. About 70 per cent of this accumulation was expected to be liquidated in the second half of 1963, assuming the absence of a steel strike. The auto industry continued at a good rate, although the inventory of used cars was relatively high.

Loans at District weekly reporting banks rose in May, while investments declined. Total bank credit showed only a slight increase, in contrast to large increases, concentrated in investments, in the same month in 1961 and 1962. Business loans declined slightly, in contrast to both the normal seasonal trend and the national experience.

Mr. Scanlon said that perhaps, if given more time to study and analyze Mr. Coombs' memorandum, he might feel differently, but at the moment he found himself in agreement with the views expressed by Messrs. Irons and Deming. In a crisis he would favor a strong move, regardless of the Treasury financing calendar, but in the absence of more convincing evidence of such a crisis he came out at about the

same place policywise as three weeks ago. This meant that he would favor no change in monetary policy right now, with no change in the directive or the discount rate.

Mr. Clay noted that the continued expansion of domestic economic activity was encouraging. The performance of the business upswing had to be viewed, however, in essentially the same way as for some time past. Despite the considerable advance in activity, the domestic economy still had a lot of room for further expansion in terms of the availability of manpower and other resources. In substantial part because of the relationship between resources and aggregate demand, price developments had been favorable. These relationships of demand, resources, activity, and prices were basic considerations to the formulation of public policy so far as domestic economic activity was concerned.

While the domestic economy continued to expand, Mr. Clay added, there were important questions concerning the thrust of the upswing ahead. One was the uncertainty as to the extent of steel strike hedging and the resulting readjustment to be expected in steel and related industries from a reversal of this factor. Another question concerned consumer spending performance as a source of expansion in view of the modest increase in that sector in recent months. A third question arose from developments in business capital outlays; the June Commerce-SEC survey indicated that the most recent quarter once again had fallen below the previous survey results. While total expenditures for the

year were essentially unchanged from the March survey, it might be significant that anticipated outlays by manufacturing firms were down somewhat from the earlier projection. The record of the third quarter should afford a better insight into the strength and pace of the business upswing that was under way.

The Committee, Mr. Clay continued, had reduced the degree of reserve availability and encouraged an upward movement of interest rates in recent weeks in an endeavor to reduce the outflow of funds. It also had been suggested that this change in policy should be carried further. In view of domestic economic conditions, however, it would appear well to him to avoid further credit restraint at this time. This would call for no change in the Reserve Bank discount rate. The directive, as adopted at the May 28 meeting, would be appropriate for a continuation of present policy, except for the words "putting increased emphasis on" in the second line of the first paragraph. Perhaps the words "putting continued emphasis on" or some similar wording could be substituted. Otherwise the wording would seem to have a cumulative impact that probably would be inconsistent with continuation of the specific instructions in the last paragraph.

Mr. Clay went on to say that a reading of Mr. Coombs' memorandum had caused him to re-examine all of the information available to him relating to the international position of the dollar. After such re-examination, however, he could not find a basis for what seemed to him

a sudden shift of emphasis on the state of the dollar. If there was additional information that could be brought to bear on the question, he would like to have it. As he read it, the memorandum did not set forth any such specific reasons to suggest immediate vulnerability of the dollar. The Open Market Committee had already assumed a posture that would afford the System a basis for moving toward tighter credit conditions. If the situation was reaching crisis proportions, there should be no hesitancy to make a dramatic move. However, the information available to him did not reflect factors that would seem to require such a move at this time. On the basis of the information at his disposal, therefore, he would favor continuing the present monetary policy.

Mr. Wayne reported that Fifth District business continued to advance slowly. The statistical picture gained additional strength in April from a substantial rise in contract awards, and in May from better-than-seasonal declines in unemployment, a slight rise in department store sales, and continuing good levels of bituminous coal output and shipments. The Reserve Bank's latest survey also reflected moderate gains. The respondents were now about evenly divided between those who expected some improvement in the near future and those who expected no significant change, with the latter group showing a substantial increase in the past few weeks. On balance their collective appraisal of the recent past suggested small gains in employment, in construction activity, and in

retail trade, including automobile sales. Manufacturers in the survey indicated a rise in new orders and shipments, accompanied by small increases in backlogs, employment, and hours. Reports from the textile industry also showed some gains in new orders and a slightly firmer price situation. Recent rains had greatly improved the agricultural outlook. In the past three weeks reserve city banks in the District felt increased pressures, which they met with increased borrowings at the discount window and moderately heavier purchases of Federal funds.

In the country as a whole, Mr. Wayne noted, business activity in May continued to show moderate improvement, thanks largely to a sharp increase in outlays for construction and continued high production of automobiles and steel. Steel orders had already dropped rather sharply, and steel production had begun to ease off. Barring some unforeseen development, steel production for the remainder of the year would quite likely be at levels significantly below those of the past three months. In view of the behavior of steel, it seemed unlikely that manufacturers' new and unfilled orders were currently continuing to increase as rapidly as they did from January through April. The May figures on employment and unemployment indicated that after seasonal adjustments there was a slight decline in total employment and a small rise in unemployment. All of these major indicators seemed to be saying that the improvement thus far had remained quite moderate and that there was no basis for expecting any quickening in the tempo in the near future if, indeed, the present pace could be maintained.

Turning to monetary policy, Mr. Wayne observed that conditions in the money market had returned approximately to those prevailing three weeks ago after some significant tightening for a few days, perhaps due in part to market reactions, to Treasury problems with the debt ceiling, and to difficulties encountered by the Desk in making accurate projections. The market seemed to be fully aware that there had been a small move toward less ease, but there was little evidence that it expected any further move of consequence in that direction in the immediate future. In the next few months the economy must adjust to a lower level of steel production, to the seasonal decline in automobile production, and to some rather heavy borrowing by the Treasury. It did not seem to him that the momentum that had been attained by the current improvement in business activity was sufficient to justify the risk that would be involved in imposing the additional burden of adjusting to any substantial reduction in credit availability, short of a situation of actual crisis in this country's international accounts. He had read the Coombs memorandum and had listened to Mr. Hayes' statement this morning, but he saw nothing in the picture to justify a dramatic change in policy at this time, and a change in the discount rate would be regarded as a dramatic move. He continued to believe that a change in the discount rate should be reserved for a crisis situation, if it occurred, with the change so dramatic as to be clearly indicative of what the System intended. There might be a

question whether a change of 1/2 per cent would constitute such a move. In the present circumstances, however, he would favor renewing the current policy directive in essence, and he would not change the discount rate.

Mr. Mills presented the following statement:

> The excellent paper that Mr. Coombs has prepared on the subject of the festering balance of payments problem afflicting the international financial position of the United States correctly diagnoses capital movements as being its root cause. Such being the case, higher interest rates are not the right cure to prescribe, both because of their inefficacy and because their adoption by policy measures would inevitably unduly restrict the availability of domestic credit, exert downward pressure on the money supply, and work consequential damage on the economy. As I endeavored to emphasize at the Committee's last meeting, a higher interest rate structure in the United States might offer some temporary relief to the balance of payments problem, but only up to the point when our foreign allies should raise their interest rates as counteroffensive measures to defend their reserves against the losses of gold and dollars induced by our actions. In that event, the entire rainbow-chasing policy would have ended in failure. As possibilities for reducing official disbursements of United States dollars abroad and obtaining further repayments on foreign advances appear to be limited, official United States control over capital outflows under Treasury administration is the logical and correct action necessary to curb our losses of reserves.
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> The heavy movements of borrowed funds to Canada and Japan, dollar loans by Belgian and Italian authorities on the London market, and announcements of future foreign loans to be made in the New York market evidence the crying need for sterner measures than a defensive interest rate structure to correct the situation. In fact, foreign observers cannot be blamed if they take a cynical and skeptical attitude to the approach thus far taken by the United States to its balance of payments difficulties. Until stern measures are adopted, it is reasonable to expect further foreign loans to be negotiated in the United States as the cheapest market available and one in which it would be nigh to impossible to officially produce a high enough domestic long-term interest rate structure as to make borrowings

abroad more attractive. Moreover, it is probable that some foreign analysts are influenced by statements of authorities of the stature of Paul Samuelson, who has publicly called for devaluation of the United States dollar, and reason that loans made in the United States are not only cheap interest-wise but conceivably can be repaid at below their original debt burden if devaluation should be compelled by financial difficulties whose correction had been delayed too long. Repeated pronouncements from official quarters that our capital markets will be kept open, and in the face of intolerable balance of payments deficits, can only lead to further doubts abroad about the financial policies being followed in this country and their sustainability.

The balance of payments situation is indeed critically serious and must be confronted aggressively. If there is no hope of meeting the problem by adoption of appropriate controls over capital outflows, and even limitations on tourist expenditures, then the final defense must resort to higher interest rates. I am personally of the opinion that development of a higher interest rate structure, and an increase in the discount rate at this time, will in the long run have harmful economic consequences, but if the Committee decides on that course, I shall reluctantly bow to the inevitable.

Mr. Shepardson said it seemed to him that the general movement of the domestic economy was encouraging. A period of normal summer slowdown was approaching, of course, and this would not argue for any further monetary policy action toward less ease at this time as far as the domestic economy was concerned. Like others who had spoken, however, he was concerned about the international situation, and he was not sure whether the System could afford to sit tight until a crisis had actually occurred. He did not know just how imminent or serious the threat of a crisis might be; if any further enlightenment was available, he would like to have it. On balance, though, he would be inclined to try to anticipate a crisis by taking less severe action than would be called for after the crisis actually had occurred.

For the moment, Mr. Shepardson continued, he felt that it would be desirable to continue present monetary policy, which he would understand to contemplate a degree of reserve availability such as to provide a fluctuation around the three per cent guideline, with some overages as well as shortfalls. However, if it became clear that the international situation was truly alarming, he felt that the System should seriously consider the possibility of acting in such manner as might seem to be required prior to the actual eruption of a crisis.

Mr. Mitchell said that on the domestic situation he found himself close to the position expressed by Mr. Wayne. He concurred in the comment of Mr. Noyes to the effect that there would be a case for letting credit markets ease a little in deference to the summer doldrums, particularly if accentuated by a steel inventory adjustment. The Committee's action of May 7 in deciding to move toward a lesser degree of ease was in his judgment a mistake. While there had been a good first half this year, the accelerating factors during that period, particularly the steel situation, had not succeeded in communicating themselves to the economy generally, notably to consumer spending. One could be fairly sure that there was going to be some decelerating in the steel industry, and this could spread more easily than the accelerating effects apparently had spread in the first half of the year. Accordingly, as far as the domestic economy was concerned, the Open Market Committee should be cautious about making any policy changes, even slight, in the

direction of tightening. It might well be that the domestic economy would not achieve a satisfactory level of operations as far as unemployment was concerned until there was a tax cut and some structual changes occurred. In the interim, monetary policy ought to do whatever it could to keep the domestic economy moving at a relatively high level. One should not forget that the present level of interest rates was high, not low, by historical standards.

Mr. Mitchell said his reading of the Annual Report of the Bank for International Settlements suggested to him the view conveyed by the excerpt Mr. Furth had read; namely, that this country was doing about everything it could to maintain the competitiveness of short-term rates and that this particular goal of monetary policy was appropriate. Further, the Federal Reserve had built a link of relationships to other central banks in the past year and a half that had provided a first line of dollar defense. What would be gained, then, from a tightening of monetary policy as far as the international situation was concerned? The thing that remained to be done was to deal with the basic balance of payments deficit arising from this country's trading and investing position. Admittedly interest rates in this country were lower than interest rates abroad, but he did not believe the disparity could be eliminated by raising interest rates here without forcing the domestic economy into a substantial downturn, one that would quickly require a complete reversal of monetary policy. As far as he could see, Mr. Mills

came to the only logical conclusion regarding the capital outflow problem. He would not accept that solution as yet, however, because he was not convinced that events had moved to the stage of crisis. Further, he felt that adjustments in Europe through inflation were proceeding and that they were not going to be halted. He also felt that political uncertainties in Europe might become sufficiently acute that the United States would become a haven for investors before too long.

In summary, Mr. Mitchell expressed the view that monetary policy should not be used to crush the domestic economy. He was rather puzzled about any suggestion for raising the discount rate to 4 per cent. This seemed to imply that once such action was taken the job would have been done and everyone could rest easily, but in his view the consequences for the domestic economy would be so serious that the Administration and the Federal Reserve System would have to face a whole new series of problems. The ideal would be to provide some evidence that this country intended to conform to monetary discipline, while not going so far as to injure the domestic economy. Basically, the only solution to the international problem consistent with a good solution domestically lay in a rapidly expanding domestic economy, and in his view this could not be accomplished through a policy of monetary restraint. As he had said, he felt that the Committee should not have decided on the policy change made in May. He would like to move back toward a little more ease.

Mr. Hickman noted that business developments of the past few weeks generally had been reassuring. However, developments in the steel industry would pose an important test for business in the months immediately ahead.

Revised April figures for retail sales, and preliminary figures for May, confirmed the generally favorable performance of the consumer sector. Total retail sales for the first five months of 1963 were 5-1/2 per cent above those of the corresponding five months a year ago, and 2 per cent above the immediately preceding five months, after seasonal adjustment. Likewise, the most recent Commerce-SEC survey of capital spending, which indicated modest increases for the third and fourth quarters, provided added reassurance of support from the business sector. Auto sales and output continued at near-record levels in May and early June.

The seasonally adjusted rate of unemployment rose slightly in May, due largely to an influx of teen-agers into the labor force. The comparable rate for adult male workers, however, remained at a favorable 4.4 per cent level, which compared with 5.1 per cent only three months ago. Moreover, the May figure for adult male workers was at its lowest level, except for one month, in the three past years.

Developments in the Fourth District, Mr. Hickman said, confirmed the strength of business activity in the nation. The most recent data for the District indicated substantial advances in construction contracts,

electric power output, and bank debits. The insured unemployment rate in the District had improved even further through early June, although at a slackening pace.

The steel situation, as indicated earlier, was now approaching the point where it would provide an important test for the general trend of business activity in the nation. Although declining steel output would act as a drag on the economy in coming months, it appeared likely that the economy would be able to absorb the adjustment without changing direction. The Reserve Bank's staff economists and other analysts in the Fourth District were in agreement that a reduction in steel output even as large as last year's could be absorbed without a decline in the Board's production index, averaged over the third quarter; most observers expected the index to rise in the fourth quarter in any event. This year, with business confidence stronger and the reduction in steel output expected to be no larger, and possibly less than last year's, the down-drag from steel should be absorbed at least equally successfully. Total steel output for the year was still projected at approximately 106 million ingot tons.

As had already been reported, the balance of payments situation did not improve in May, which portended a second quarter record no better than that of the first quarter. The dollar still appeared to be under pressure despite a slight improvement in the foreign exchanges. Capital outflows remained large, in Mr. Hickman's opinion, because of the relatively favorable terms of financing in this country and the ready availability of funds.

In regard to policy, Mr. Hickman said it seemed to him the point had now been reached where the effects of the slight shift towards less ease adopted several weeks ago had been fully absorbed by the market, the financial community, and the national economy. He believed that another step in the same direction was now needed. With the Treasury due to come back into the market for funds late in July, this action should be taken promptly. He would recommend a bill rate in the 3-1/4 - 3-1/2 per cent range, with free reserves around $100 million, or lower if needed to bring about an appropriate upward adjustment in the term structure of interest rates. This would pave the way for an increase in the discount rate, possibly before the next meeting of this Committee. The directive should be reworded to call for increased firmness in the money market, rather than a continuation of the same degree of firmness.

Mr. Hickman went on to say that the foregoing remarks reflected his views before reading Mr. Coombs' memorandum. Having read that memorandum, he was more than ever convinced that the System should move promptly toward a 91-day bill rate in the range of 3-1/4 - 3-1/2 per cent. This would not solve the country's balance of payments difficulties, but it would help to overcome them, and it would put those who could help most on notice that the situation required urgent attention. In Mr. Hickman's opinion an increase of 1/2 per cent in the bill rate would have little effect on the business situation. He felt that business

would level off and then increase in any event in the months to come unless there should be a dollar crisis, which all possible steps should be taken to avoid.

Mr. Bopp reported that developments in the Third District in the past three weeks had been disappointing. Because of the timing of today's meeting, many figures for May were not available. The most current data, however, all reflected deterioration or a continuation of depressed levels.

Earlier hopes for improvement in unemployment claims had been partly dashed by the latest figures. Advance indications presaged some decrease in the Philadelphia help-wanted index for May. Steel production, which never did match the national rise, had dropped more from its top than the national index.

Perhaps symbolic of conditions in the District was the behavior of department store sales. They had fallen below the comparable totals of 1962, and indeed in this respect had turned in the nation's worst performance. The estimated May index indicated a small improvement over April, but not enough to foreshadow any change in the downward average movement that began late in 1962. Although special causes (including a transit strike and the loss of one department store) accounted for some of this poor performance, a review of Third District information indicated that in large part the disappointing store sales results had been associated with generally sluggish business in the District.

A progressive tightening appeared to be taking place at Third District banks. The basic reserve position of reserve city banks fell from plus $26.6 million in mid-May to minus $93.6 million in early June. Country bank borrowing at the discount window rose progressively from about $600,000 to $3.5 million, the highest figure reached this year on a weekly average basis. Data available for the last half of May and first week in June indicated that bank credit at reporting banks increased while total deposits adjusted fell. The loan increase was about double that occurring in the same period last year. Loans to sales finance companies and to other financial institutions rose, as did real estate and "all other" loans. Business loans, however, had remained quite sluggish.

With conditions as they were in the Third District, Mr. Bopp said, he started with a natural bent toward a policy of monetary ease. Looking at the larger picture, it appeared to him that the national economy was continuing a moderate, unsatisfactory rate of progress characterized by unacceptable levels of unemployment and resource utilization. Recent developments had, if anything, made this fact clearer and seemed likely to dispel the more extreme forms of optimism that had circulated in the past few weeks. This view of the national economy, therefore, reinforced his preference for ease.

The outlook for the balance of payments, of course, was not good, Mr. Bopp added. On the other hand, prevailing levels of short-term rates

did not offer strong incentives for significant movements of funds on a covered basis. For this reason, he believed further tightening would not be appropriate at this time. The Committee had taken a position of less ease than he would prefer, but he would not now recommend a reversal of that position. Debt management policies had accomplished very recently some of the results that he would like to see achieved by monetary policy. The improved tone of the money and capital markets that had resulted from the new cash offering seemed to him desirable (although the speculative overtones of the issue were, of course, disturbing). As these effects wore off, he would hope that the Desk could prevent any sharp shift in the tone of the market. Perhaps it would be necessary to rely on the law of averages to produce "misses" on the easier side. In the meantime, however, he would like to see a reserve supply somewhat more plentiful than had been the case in recent weeks.

Mr. Bopp expressed the view that a change in the discount rate would not be in order at this time. Some change in the first sentence of the directive might be appropriate to avoid a cumulative emphasis on the balance of payments. This could be accomplished by substituting "maintaining" for "putting increased emphasis on."

Having read the Coombs memorandum rather hastily, Mr. Bopp said, a point occurred to him that might deserve some thought. If there should be a dollar crisis, he assumed the tendency would be to think in terms of some dramatic credit-tightening action. This would have reverberations

in the United States and the rest of the world. An alternative would be to resort to the International Monetary Fund and other drawings to work through the crisis. Two or three decades from now, others might look back and say that this would have been the preferable course.

Mr. Bryan commented that Sixth District figures were sufficiently close to national trends to make a detailed recital of District statistics unnecessary. Both in the District and in the nation, the broad diffusion of gains shown by economic indicators was impressive. Also reassuring was the moderate uptrend in plant and equipment spending, coming at a time when the economy would probably be disturbed by a let-down in steel.

In the meantime, the money supply (narrowly defined) exhibited about a 2.6 per cent increase measured against year-ago figures. The total money supply (including time deposits) exhibited a 7.7 per cent increase from year-ago figures. Total liquid assets and personal-type savings continued to show persistent and sharp uptrends. These factors probably went a long way toward explaining why the rate reaction to the System's recent policy shift had been modest and probably indicated that forces that had kept interest rates remarkably steady for so long were still at work.

In the light of what he considered a satisfactory economic trend and prospect, even though no boom was apparent, Mr. Bryan believed that System policy should be "firm" but not "tight." He conceived that to

have been the System's posture, on average, over the past few weeks. In that sense, he believed monetary policy should continue unchanged. Tightness should develop, if at all, from market demand against a modestly expanding reserve base. If he were to state an instruction in terms of free reserves, he would say that the Committee ought to aim at a level (daily average basis) falling within a range of $100 million to $200 million, but preferably toward the lower end of that range. However, he would like to point out that what he regarded as more basic reserve figures still exhibited an overage from December, when policy shifted--an overage as measured against even a 3 per cent growth factor. This point was discussed in the staff memorandum on reserves. He still believed, as he had recently been saying, that it would be preferable to fall back to a 2 per cent growth rate in seasonally adjusted reserves despite the case presented by Mr. Koch.

Total reserves, incidentally, had been exhibiting a slightly greater borrowed component, Mr. Bryan noted. He regarded this development as appropriate in existing circumstances. Since the increase in borrowings presented no policing problems at the moment, and a change in the discount rate would be taken as an announcement of a considerable, even a drastic shift to a policy of restraint, he would not presently consider an increase in the discount rate as desirable, particularly when considered in the light of the situation with respect to manpower, materiel and productive capacity.

Mr. Bryan commended Mr. Coombs' memorandum for its contribution to Committee thinking. Essentially, he pointed out, the argument made in the memorandum rested for validity on points that he (Mr. Bryan) was not fully in a position to judge. It appeared, however, that an interest rate adjustment, as referred to in the memorandum, would have to exert a substantial impact on capital outflows without at the same time creating offsetting domestic repercussions, and Mr. Bryan was not certain in his own mind whether these dual objectives could be achieved. Second, it seemed that if such action were to influence capital outflows, there must be an assumption that European rates would not follow U. S. rates upward, and he was not entirely sanguine on that score. From his readings, there appeared to be developing in Europe--as elsewhere in the world--a new wave of nationalism, though perhaps in somewhat different form from the nationalism of the past. Further, the measures mentioned in the Coombs memorandum might have a desirable technical result, but of a relatively temporary nature, and Mr. Bryan was skeptical of the value of good temporary results. He was by no means philosophically convinced that the Federal Reserve System had performed a good service through its program of foreign currency operations. These operations had been technically successful and capably handled, but he wondered if it might not have been better just to lose gold. Things of a more fundamental nature had to be done about the balance of payments.

In a further comment, Mr. Bryan noted that the Coombs memorandum had suggested that it might be possible to raise the short-term rate

toward 3-1/2 per cent and at the same time prevent a proportionate--or perhaps even any notable--increase in long-term rates. Mr. Bryan doubted whether this could be done. The rate curve was already quite flat; a rate curve as flat as the memorandum seemed to contemplate could easily lead to the unfunding of the public debt with a large volume of long-term Government securities being offered to the Federal Reserve System.

Mr. Shuford reported that business activity in the major cities of the Eighth District continued to improve moderately from April to May. However, the level of business activity was only slightly higher than a year ago. Preliminary figures suggested that employment in the major labor markets rose from April to May. Bank deposits rose rapidly in April and May and business loans had increased since March, regaining the growth lost early in 1963. Generally speaking, business conditions in the District were roughly parallel to those in the nation. Altogether, the improvement that had been seen recently was encouraging, even though there was no evidence of an economic boom.

Mr. Shuford noted that the balance of payments situation--regardless of whether it had approached crisis proportions--was serious. As he had observed on other occasions, the real correction lay in areas other than monetary policy. He would like to see additional and more positive actions taken in some of those areas. A meeting of the problem through increasing short-term rates would appear to afford only temporary relief and might prolong the fundamental corrections toward which the

country should be working. At the same time, monetary policy had a role to play; in his view it had already played a significant role. Also, he recognized that most of the fundamental corrections were longer range in nature. Therefore, if it appeared that a crisis situation was approaching, he would be willing to consider an increase of some magnitude in the discount rate, either 1/2 or 3/4 per cent. If the situation had developed to a point of urgency, and if a significant move seemed necessary to safeguard confidence in the dollar, he would certainly think it desirable to consider taking such a measure. However, he hesitated to conclude that a crisis situation had been reached; if additional facts were available, it would be helpful to have them. Before reaching any final conclusion on the discount rate, he would prefer to wait and hear a full discussion.

Therefore, Mr. Shuford said, he would prefer to continue the degree of money market firmness that had existed over the past three weeks. He would prefer no change in the discount rate unless it should be decided that a crisis situation clearly was approaching.

Mr. Latham reported that basically the New England economy continued to show improvement, although still lagging behind the national rate of growth. Bankers and businessmen generally reflected cautious optimism, expressing the opinion that the local economy was at a high level, moving slowly but steadily upward.

Purchasing agents reported higher production and increased new orders in May, with fewer decreases compared with April. Personal incomes appeared to have slowed in growth rate, although still running ahead of last year.

May department store sales were good and were running generally 3 per cent above a year ago in early June. New car sales and registrations continued at high levels, with dealers optimistic.

Savings deposits resumed their upward trend after the April dividend lull, with new deposits exceeding withdrawals at mutual savings banks, where the annual growth rate was running at about 7 per cent.

Loans continued at high levels at member banks, with loan-to-deposit and liquidity ratios at 68.8 and 13.4 compared with 65.9 and 17.9, respectively, a year ago. Loans and investments in municipals continued to rise at the expense of both short and longer term Governments.

The sentiment expressed by officials of the District's larger banks was in favor of current System policy, with the feeling generally that money had been too easy.

Mr. Hemmings reported that a number of key indicators of economic activity in the Twelfth District showed gains. The employment situation appeared to have improved slightly in May, while the unemployment rate in California and Washington, which together account for 80 per cent of total Twelfth District employment, dropped slightly below the April level

of 6 per cent. Lumber prices had risen because of a widespread strike in the Pacific Northwest and an increase in new orders. Steel production was up more in May and fell less in June than nationally, and there was a continuing high level of construction activity in most District States. Consumer buying was strong in May, with department store sales up 8 per cent from April. New car registrations in California were down in the first half of May compared with April, but nevertheless reached a record for this particular period.

A number of savings and loan associations in Southern California and Arizona had announced cuts in dividend rates to take effect either in July or September. Generally speaking the reduction would be from 4.8 per cent to 4.5 per cent. There were some indications that reductions also might occur at savings and loan associations in the San Francisco area in the third quarter.

From May 15 to June 5, business loans at District banks declined more than in the corresponding period a year ago, but security holdings increased in contrast to the decline nationally and more than offset the decrease in total loans. Time deposits were up more than in the corresponding period a year ago. The larger banks continued to be net sellers of Federal funds, and net sales increased somewhat during the past week.

Mr. Balderston observed that the international situation presented not only the question of what should be done but when. The indication of increasing unwillingness of foreign central banks to hold dollars, as

referred to in Mr. Coombs' memorandum, was not a new or surprising development. Foreign bankers who had visited here during the past year had been indicating clearly that they were holding dollars with increasing reluctance.

As to Mr. Shepardson's admonition against waiting for an actual crisis to occur to trigger defensive action, Mr. Balderston indicated that he agreed in principle. It appeared that the System would be well advised to take suitable action as early as it could find ways of taking such action. He also hoped that steps might be taken toward some reduction of the flow of Government spending abroad for military purposes and toward confining foreign aid to essential projects that the United States could afford under present conditions. As to the outflow of private capital, he believed that direct controls would not work because of the opportunities for avoidance. He could not imagine any controls that would not have many leaks. Further, he believed that widespread discussion of direct controls would serve to precipitate developments such as the Committee was worried about this morning. Possibly tax deterrents could be administered more effectively. That might be a more feasible approach if such deterrents could be placed in effect without extended debate that might precipitate a crisis.

As to monetary policy, Mr. Balderston indicated that he considered the question of timing to be most difficult. For the forthcoming three weeks, however, he would favor continuing within the general scope

of the policy adopted on May 7, but with enough further lessening of ease to encourage the bill rate to move about 3 per cent. Looking at the recent behavior of the stock market, the increase in farm land values over the past year, the sporadic price advances reported during recent weeks, the continued upward movement of time and savings deposits, and the continued upward movement of wage rates and fringe benefits, it appeared that the economy had more liquidity than it could make use of effectively. Flooding the country with liquidity would not put to work the younger folks who had recently left school and wanted jobs, which unfortunately had been priced out of their reach.

Chairman Martin commented that he was more and more convinced that domestic and international considerations could not be separated at this juncture. In his opinion, the shift in policy toward slightly less ease at the May 7 meeting was appropriate; the situation would be even more difficult if monetary policy was not in its present posture. Further, he did not believe that the domestic economy would suffer from a lesser degree of monetary ease. Instead, he felt that it would benefit, strange as that might seem--and the balance of payments position would at least temporarily be improved. Whether it would be improved over the longer run was, as Mr. Bryan has suggested, a different story, but the System could not be responsible for all of the factors in the current situation. The views presented in Mr. Coombs' memorandum involved, of course, an element of judgment. One could not be sure whether Mr. Coombs

had accurately assessed the present situation, and probably this would not be known for some time. He (the Chairman) had been talking crisis himself for perhaps 15 months. It might take another 15 months before a crisis actually occurred, if it did occur. However, there were indications, including reports in the press, of an ebbing of confidence in the dollar at this juncture.

In further comments, the Chairman pointed out that no one could foretell how much effect changes in monetary policy out of deference to the international position of the dollar might have on the domestic economy. Nevertheless, there were some inconsistencies in the present debate that he felt should be pointed out. For example, the argument was made that higher interest rates would not achieve any results from the standpoint of the balance of payments, but on the other hand it was maintained that higher interest rates would be disruptive to the domestic economy. In his opinion, one could never know about this sort of thing in the absence of experimentation. Personally, he would hate to see an abrupt move on the discount rate in an actual crisis situation, feeling that it would be sounder to move in an orderly way and try to let the traditional forces operate unless it became clear that they would not work.

The fact must be faced, Chairman Martin continued, that timing was a key problem. In his opinion, the System should not necessarily feel bound by the traditional even keel policy during periods that the

Treasury was in the market. When it came to the question of timing, he noted, it must be realized that everyone was likely to have different judgments. It might be that a payments crisis would come, although he was not convinced that it was here now. However, while he did not pretend to know the right timing for System policy action, he was convinced that the country ought not to take a step such as devaluation of the dollar or the institution of direct controls before interest rates had been given some chance to have a play on capital flows. Unfortunately, he felt that he detected around the country a growing sentiment that devaluation was the answer, or that direct controls were the answer. This was disheartening to him. He hoped that there would not be such an experiment before indirect controls and market forces were given an opportunity. If direct controls were used, the trend toward nationalism about which the Committee had been talking was apt to become worldwide overnight. The United States was the last strong citadel of multilateral nondiscriminatory trade and convertible currencies as world policies. Its leadership in the world stood on that fact.

Chairman Martin added that although the time might be at hand for cutting back on foreign aid and military expenditures abroad, the System was not in a position to take such steps. In terms of capital flows, however, he had some feeling that a modest change in interest rates at some point would do more to restore confidence. Economists, he thought, had never quite come to grips with the item of confidence and the things that go with it. Things ought to be locigal, but the market

is never logical and people are never logical. It seemed important to try to find a middle ground.

The Chairman said that personally he would be inclined to move modestly toward less ease. He added, parenthetically, that he questioned the use of the word "tightness" at this juncture. Never had he seen a period when there was so much loose speculation with money. The practice of American banks in using the Euro-dollar market was growing all the time, and this was due primarily to interest rate differentials. This should be a matter of concern to the Federal Reserve System.

To repeat, the Chairman said, he was convinced that no consideration should be given to moves such as devaluation of the dollar or direct capital controls until there had been a testing to see whether the domestic economy was going to be set back by moves in the area of indirect controls.

As to today's meeting, Chairman Martin noted that the majority opinion within the Committee seemed to favor no change in the present monetary policy although it might be a rather close call, insofar as the current position was concerned, between no change in policy and slightly less ease.

The Chairman added the comment, in this connection, that it was hardly appropriate to start talking about tight money until net free reserves gave way to net borrowed reserves. He also expressed the view that there were many tenuous elements in the current situation. No matter whether one looked at the stock market or the real estate market, small

business activities, or some of the fringe activities of defense operations, there was a speculative movement around the country that was in a way reminiscent of the 1929 period. He did not believe that this situation was likely to come to a head within the next six or nine months, and he hoped that he was too pessimistic with regard to the international situation, but he felt that the monetary and credit situation in this country was not healthy. Wherever one looked, there was too much credit available, whether it was in the area of consumer instalment credit or real estate credit or some other area, and this was a hazard that must be recognized. He would only propose today that the problem be kept closely in mind.

The Chairman then suggested that a vote to be taken on the basis of no change in present monetary policy during the forthcoming three weeks, which would be signified by making no change in the current economic policy directive.

> Accordingly, upon motion duly made and seconded, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System 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 shall be conducted with a view to continuing the degree of firmness in the money market that has prevailed recently, while accommodating moderate reserve expansion.

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

Messrs. Hayes and Balderston dissented because they felt that the Committee should move in the direction of slightly less ease, while Mr. Mitchell dissented because he favored a return to the greater degree of ease that had existed prior to the shift of policy decided upon by the Committee on May 7, 1963. Chairman Martin said that, as indicated by his earlier comments, his inclination was to move toward less ease. He would have so voted if he had thought it would serve any purpose to take that position at this time.

It was noted that the Account Manager had recommended, in his oral report today, that the continuing authority directive to the Federal Reserve Bank of New York be amended to raise from $1 billion to $1.5 billion the limit on changes in the System Open Market Account during the next three weeks.

Upon motion duly made and seconded, and by unanimous vote, section 1(a) of the continuing authority directive was amended so as to authorize and direct the Federal Reserve Bank of New York, to the extent necessary to carry out the current economic policy directive:

(a) To buy or sell United States Government securities in the open market, from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing United States Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account (including forward commitments, but not including such special short-term certificates of indebtedness as may be purchased from the Treasury under paragraph 2 hereof) shall not be increased or decreased by more than $1.5 billion during any period between meetings of the Committee.

Mr. Hayes stated that there had been several points made during today's discussion that he felt warranted some comment. First, the Annual Report of the Bank for International Settlements did contain the sentences that were read by Mr. Furth. Reading the full report, however, or at least the sections on interest rates, he felt that clearly the atmosphere was one of favoring a less easy monetary policy in the United States. This was also the thinking of European central bankers with whom he (Mr. Hayes) had been in contact.

As to direct capital controls, Mr. Hayes expressed agreement with the observations of Chairman Martin and Mr. Balderston. This would be a futile thing to get into if the System had not done everything possible to avoid such controls through the use of conventional monetary instruments.

It represented indulgence in wishful thinking, Mr. Hayes felt, to hope that inflation and political upsets in Europe could be relied upon to solve the U. S. balance of payments problem. With reference to the suggestion that European central banks just be allowed to take U. S.

gold, he could think of nothing that would be much more likely to trigger a loss of confidence by U. S. citizens generally. With reference to the question of short-term rates, he warned against placing too much reliance on the fact that covered rates were now fairly well in balance. This represented overemphasis on one phase of the short-term rate picture. A great many flows were going on without reference to the covered rates.

As to the suggestion that a move on the part of the System should be one intended to have some lasting effect, Mr. Hayes said that if a higher short-term rate structure could be achieved, possibly that would have lasting effects for years in the balance of payments area. As to long-term rates, he had only suggested softening the effects of a policy move at this time to see whether they could be confined mostly to the short-term area. If so, obviously this would have advantages for the domestic economy.

On the question whether any change in the discount rate should be in the order of one-half per cent or one per cent, Mr. Hayes said he came out clearly in his own mind that an increase of one-half per cent would be vastly preferable. The necessity of having to make a larger adjustment might be obviated by making a smaller move sooner. An increase of one-half per cent would provide a strong signal of what the System intended, especially since the discount rate had been at 3 per cent for such a long time. It should have the effect of encouraging actions

by other parts of the Government as effectively as a larger increase, but it would be less conducive to a move on the prime rate. It would do less to complicate the Treasury's problem, to engender political difficulties, and to generate offsetting actions abroad.

As to whether there was indeed a payments crisis at hand, Mr. Hayes noted that no one could tell for certain about the timing. As Mr. Balderston said, this had been developing slowly over a period of time. Mr. Hayes was rather surprised that some of the Committee members seemed to feel that something might have been happening during the past few weeks about which they had not been informed. It was a matter of judgment as to when a process that had been developing over a long period of time would get to the breaking point. He agreed with what Mr. Shepardson and Mr. Balderston had said about anticipating rather than waiting. A mild move would run much less risk of harm to the domestic economy than a severe move, and he could not see why anyone would want to wait until the last moment before doing anything. It was human nature, of course, to want to pass the buck to someone else to solve a problem, but he could see signs that the Government in general was increasingly aware of the seriousness of the problem. The System should not fail to be among the ranks of those who were ready to do their part.

Mr. Mitchell did not agree that the System could make any policy move that would change the fundamental relationship of the two ends of

the interest rate structure. In order for that to occur, the marginal efficiency of capital in this country must rise, and no policy the System could adopt would make that happen. What could develop was an artificial structure in which interest rates would be fixed, as they had been at the short end. This was one reason why people had so much money; there was no reason to fund under the existing rate structure. Mr. Mitchell agreed that the question of timing was an important point. In his view there should be either a structural change at home or definite evidence that the economy was on its way before it would be appropriate to use the kind of medicine Mr. Hayes was advocating. It would never solve the question of the marginal efficiency of capital in this country.

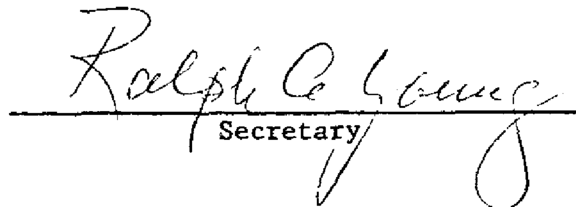
Mr. Hickman commented that the marginal efficiency of capital involved an equating of expected future returns and present costs. The expectational element depended in part on the degree of concern about the balance of payments situation. If this was a factor deterring investment it would appear that a firmer monetary policy would raise the marginal efficiency of capital. In other words, decisions to invest involved judgments as to the future, which included concern about the precarious position of the dollar. It seemed to him that there was much to be said on both sides of the question. The raising of interest rates might deter some investment, but at the same time it would represent a forward step in dealing with the balance of payments problem. Failure

to take action might result in undermining the quality of credit and lay the groundwork for a recession in the future. In his opinion, an unduly easy monetary policy was not going to help unemployment or promote the longer run utilization of capital in this country.

The discussion concluded with further comments by the Chairman and other members of the Committee, reflecting their views on various aspects of the domestic credit situation and the balance of payments problem.

It was agreed that the next meeting of the Open Market Committee would be held on Tuesday, July 9, 1963.

The meeting then adjourned.



Secretary