A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, September 10, 1963, at 9:30 a.m.

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

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

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

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

Mr. Molony, Assistant to the Board of Governors
Mr. Cardon, Legislative Counsel, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Broida, Chief, Consumer Credit and Finances Section, Division of Research and Statistics, Board of Governors
Mr. Spencer, General Assistant, Office of the Secretary, Board of Governors

Messrs. Hilkert and Patterson, First Vice Presidents of the Federal Reserve Banks of Philadelphia and Atlanta, respectively
Messrs. Mann, Ratchford, Taylor, Jones, Parsons, and Grove, Vice Presidents of the Federal Reserve Banks of Cleveland, Richmond, Atlanta, St. Louis, Minneapolis, and San Francisco, respectively
Mr. Marsh, Assistant Vice President, Federal Reserve Bank of New York
Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston
Mr. Sternlight, Manager, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on July 30, 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 August 20 through September 4, 1963, together with a supplementary report covering the period September 5 through 9, 1963. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Coombs observed that the U. S. gold stock would remain unchanged this week. There was a sufficient balance in the Treasury Stabilization Fund to take care of immediate foreseeable needs, and he was hopeful that it might be possible to get through the remainder of this month without showing further losses in the gold stock.

In the London gold market, a certain amount of speculative buying had developed during the last few days of August, resulting in depletion of the gold pool. The proposed interest equalization tax was a disturbing influence, along with the recent Brookings study recommending flexible exchange rates. There were also the usual rumors in advance of the annual meetings of the International Monetary Fund and the International Bank. The gold market developments began to worry some Western European bankers, but the Russians then came in with sizable gold sales and the gold pool was able to acquire a substantial part of those sales.

The U. S. dollar had shown a mixed pattern in the foreign exchange markets, being firm against sterling, the Canadian dollar, the guilder, and the lira, but weak against the French franc, the Swiss franc and the mark. The total flow of dollars to Germany and Switzerland had not been sizable in recent weeks, however, and there had been a noticeable decline in the intake of dollars by the Bank of France. In summary, there had been a gradual improvement in the over-all position of the dollar. A major factor appeared to be the proposed interest equalization tax, which was placing a virtual freeze on new foreign flotations in the U. S. market. However, the recent improvement in the balance of payments figures was mainly at the expense of Canada and Japan. The longer run consequences of the tax were difficult to estimate, but Mr. Coombs was inclined to feel that they might be much less than the short-run influence.

There were also a number of indications that the recent rise in U. S. short-term interest rates was beginning to encourage a repatriation of U. S. corporate funds previously placed in the Euro-dollar market. The situation appeared to be at a point where even a moderate easing abroad, coupled with a firm short-term interest rate structure in this country, would bring about a substantial inflow of short-term funds.

In reply to a question about the effect of the interest equalization tax in light of the proposed exemption of Canadian issues, Mr. Coombs said that until the tax was actually passed, no one was prepared to take a Canadian issue for fear the Congress might not approve the exemption. The same thing applied in the case of Japan. In the short run, the proposed tax would exert a substantial effect on the balance of payments statistics, like the virtual freeze on the flow of short-term funds to Canada in the first part of 1962.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period August 20 through September 9, 1963, were approved, ratified, and confirmed.

Turning to recommendations for consideration by the Committee, Mr. Coombs pointed out that the $250 million reciprocal currency agreement with the Bank of Canada, currently on a standby basis, would mature September 26, 1963. He recommended its renewal for a period of three months.

In discussion, which centered around the relatively large size of the Canadian arrangement, Mr. Coombs brought out that Canada was the most important trading partner of the United States. He felt that the relationship of the British and Canadian swap arrangements ($500 million and $250 million) was about right. In relation to the British swap arrangement, the swap agreements with two or three of the Continental central banks were probably on the low side, and in due course it might be desirable to attempt to work out somewhat larger swap lines in those cases.

Thereupon, the renewal of the reciprocal currency agreement with the Bank of Canada, as recommended by Mr. Coombs, was approved unanimously.

Mr. Coombs noted that three drawings of $25 million each under the swap arrangement with the German Federal Bank would mature September 18, September 20, and September 23, 1963, respectively. It appeared that during September there might be rather substantial payments by the German Government to the United States for military hardware. If the remainder of the payments balance between the two countries was roughly in equilibrium, it might be possible to pay off the swap drawings by buying marks against the dollars used by the German Government and by buying the necessary additional marks through the market. If developments did not unfold in this way, however, he would recommend renewing the swap drawings for three months. In each case, this would be the first renewal of the drawing.

The renewal of the three swap drawings, if necessary, was noted without objection.

Proceeding to his third recommendation, Mr. Coombs noted that the $12.5 million System drawing of French francs under the swap line with the Bank of France had been completely covered by equivalent purchases of French francs forward. Thus the swap drawing would be repaid by around the end of October. The forward purchases were made under the $25 million authorization for forward purchases of foreign currencies that was given by the Committee on March 5, 1963. Mr. Coombs felt that this had been a useful operation and that it would be desirable to provide room to take care of other similar opportunities that might appear. He recommended, therefore, that the authorization for forward purchases of foreign currencies be increased from $25 million to $50 million.

In reply to questions, Mr. Coombs stated that it would be the intent, if the increased continuing authorization were granted, to acquire from time to time currencies in which the System had a short position as the result of drawings under swap lines. At the moment, only the German and French swap drawings were outstanding, but in the future there might be other drawings where forward purchases would be useful in arranging for repayment. This seemed a businesslike way of taking care of debts incurred. In the French case, before the due date of the drawing, the possibility arose of buying francs forward at a discount, and in this manner the drawing was completely covered. The Committee's Guidelines, he pointed out, specify that forward purchases should be

cleared in advance, and this had been done. He did not think that forward purchases in such circumstances could be regarded as an unwarranted manipulation of normal market processes. Instead, it amounted to anticipating the repayment of drawings by buying forward rather than waiting to buy spot. If the needed currency was available at a discount, its purchase forward would seem to be a businesslike way of handling the repayment of a drawing.

Mr. Mitchell commented that he thought several members of the Committee felt some concern as to whether System foreign exchange operations might tend to obscure normal market forces. He found himself trying to evaluate the extent to which System operations might tend to obscure fundamental adjustments in the process of taking place in the market.

Mr. Coombs said that he could understand this concern. There was clearly the potential in System foreign exchange operations of doing what had been suggested. However, in view of the way that System operations had been conducted, he thought that this had not been the case. Whenever the System had run into great pressure, it had yielded to the pressure and backed away; in no instance had an attempt been made to dig in and maintain an artificial rate. As to forward operations, he felt that the risk of distorting market forces was less than in the case of spot operations. There was admittedly a real risk in the whole area of System operations of obscuring basic market forces. On the

other hand, the System had drawn under its swap lines only on occasions when it appeared that existing flows of funds might be reversible.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the continuing authority directive for System foreign currency operations was amended, effective immediately, to read as follows:

The Federal Reserve Bank of New York is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the Guidelines on System Foreign Currency Operations reaffirmed by the Federal Open Market Committee on March 5, 1963, as amended on May 28, 1963:

Pounds sterling
French francs
German marks
Italian lire
Netherlands guilders
Swiss francs
Belgian francs
Canadian dollars
Austrian schillings
Swedish kronor

The Federal Reserve Bank of New York is also authorized and directed to purchase, in accordance with the Guidelines and for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements, any or all of the foregoing currencies through forward transactions, up to a combined total of $50 million equivalent.

The Federal Reserve Bank of New York is further authorized and directed to purchase and sell, in accordance with the Guidelines and for the purpose of utilizing its holdings of one currency for the settlement of commitments denominated in other currencies, any or all of the foregoing currencies through forward as well as spot transactions. up to a combined total of $50 million equivalent.

Total foreign currencies held at any one time shall not exceed $1.75 billion.

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 August 20 through September 4, 1963, and a supplementary report covering the period September 5 through September 9, 1963. Copies of these reports have been placed in the files of the Committee.

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

> During the past three weeks we were able to maintain about the same degree of firmness in the money market as in the previous period while supplying reserves to meet normal monthly drains and Labor Day needs without creating downward pressures on short-term rates. In fact, due to a combination of fortuitous circumstances bill rates ranged somewhat higher, with the 91-day rate between 3.38 and 3.40 per cent until the last three days of the period when downward pressures have developed as a result of the Treasury's advance refunding operation.
>
> Over the period the System supplied a net total of $516 million reserves, $288 million through purchases of bills, $78 million through purchases of coupon issues, and $150 million through an increase in holdings of repurchase agreements. $247 million of the bills were purchased in the market, consisting of very short maturities offered to us in large blocks as dealers took them back from corporation repurchase agreements; $41 million of other bills were purchased from foreign accounts. These purchases had practically no effect on market rates for bills. The $78 million coupon issues were bought on August 23, after which no further operations were undertaken in these issues in view of the imminence of the Treasury's advance refunding operation. In the last part of the period, additions to reserves were made through increases in repurchase agreements, which were facilitated by large increases in dealer portfolios just before and after Labor Day.
>
> At the time of the last meeting of the Committee bill rates were around 3.35 per cent bid for 91-day bills. In the next few days rates backed up to about 3.40 per cent bid as nonbank demand

tapered off and dealers displayed a cautious attitude in the face of the three bill auctions scheduled for the week before Labor Day, including the first billion dollars of the new monthly one-year bills. Dealers bid quite aggressively in these auctions, anticipating better demand at the higher rate levels, particularly as an outgrowth of the expected advance refunding. They also felt that the authorities would be satisfied with rates this close to the discount rate. Their awards in these three auctions were quite substantial, totaling $2,225,000,000, and their trading positions were increased well above $2 billion, where they remained, acting as a damper on the market, at least until the announcement of the advance refunding last Wednesday.

In planning for the advance refunding, the Treasury had recognized that the "prerefunding" portion, or the part involving the extension of relatively short maturities, could create downward pressures on short rates. They had expected to make a simultaneous announcement of an auction of a strip of Treasury bills to counteract this effect but decided to delay this action until they were actually faced with the need for it. However, in announcing the advance refunding, they stated that it was intended to meet the cash needs of approximately $6 billion for the remainder of calendar 1963 largely through offerings of Treasury bills. Also, they said that the timing and magnitude of these borrowings would be adjusted to the pattern of cash requirements and the needs of the balance of payments situation. The most recent Treasury estimates show excessively high cash balances, at least through the end of September, so that they now feel inhibited from borrowing any new cash in the near future, which is unfortunate in view of the effect the advance refunding is having in increasing the demand for bills. Since the Treasury's announcement last Wednesday a fairly substantial amount of "rights" has been sold against purchases of bills with the result that the 91-day rate has backed down to 3.34 per cent bid and dealer bill positions have been reduced below $2 billion. Yesterday's auction (in which the three- and six-month rates were 3.34 and 3.46 per cent, respectively) and market performance did not reflect any further downward pressure on bill rates; in fact, the dealers were awarded $820 million more new bills in the auction. However, if there should be a resurgence of demand, we could find it difficult to keep the bill rate from falling lower in the absence of assistance from the

Treasury. The quarterly tax date is expected to have little effect on the Treasury bill market.

As you are probably aware, the refunding package is made up of two parts, the "prerefunding" in which the holders of the large May 1964 maturities are offered three new issues, 3-7/8s of 1968, 4s of 1973, and 4-1/8s of 1989-94 (which will be reopened), and the "junior advance refunding" in which holders of four issues due in 1966 and 1967 are offered the 4s of 1973 and 4-1/8s of 1989-94. The terms are generous, including substantial cash payments by the Treasury which result in a yield as high as about 4.20 per cent to the buyers of "rights" who wish to exchange into the long-term 4-1/8s. There was some initial surprise that the operation covered such a wide range of eligible issues and included an offering of a long bond. The reception has been favorable up to now, but the attractive pricing against the market required a substantial adjustment on Thursday in prices of outstanding issues running from 1/8 of a point in the 1968 area to 3/4 of a point in the longest term issues and almost two points in the reopened 4-1/8s of 1989-94. The Treasury has expected an exchange of the $23 billion of public holdings of eligible issues to the extent of about 25 per cent, or $6 billion. It is too soon to tell how it will work out, but it seems likely that this goal will be reached and that the exchange into the long 4-1/8 per cent bonds will be substantial, possibly as much as $1 billion. The books for the exchange will close this Friday, September 13, and the payment date will be Wednesday, September 18.

Aside from the technical price adjustment in Government securities, the capital markets in general have not yet shown any significant reaction to the higher yields made available on the long bonds. There has been some slight softening in the market for corporate bonds as two long-standing syndicates were broken last week, but activity generally has been light as the market awaits the results of the advance refunding. In view of the projected high level of its cash balances, the Treasury is taking advantage of the supply of securities generated by the advance refunding to purchase a substantial amount of intermediate and longer term issues for the trust accounts. This will not only put the excess cash to work but also will reduce the total outstanding debt, which the Treasury

believes will be bumping against the ceiling after the first of October. We don't yet know the total magnitude of this program, but it is safe to say that it will minimize any possible effect of the advance refunding on longer term rates. The market has not yet become fully aware of these purchases, and it may well be that after the entire refunding operation is over, long rates will fall back to the range somewhat above 4 per cent where they have been for some time.

In discussion, it was suggested that if the market became aware of substantial Treasury purchases of longer term issues, this might provoke a speculative situation. Mr. Marsh replied that this subject had been discussed with the Treasury yesterday. It was pointed out to the Treasury that this could encourage redundant subscriptions to the 4-1/8 per cent bonds. The Treasury was aware of the possible result and actually had not been buying the 4-1/8 per cent bonds direct to any extent. Most of its purchases had been in other issues, mainly the 4 per cent bonds of 1980.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period August 20 through September 9, 1963, were approved, ratified, and confirmed.

At this point Mr. Hexter, Assistant General Counsel of the Committee, and Messrs. Conkling and Daniels, Assistant Directors of the Board's Division of Bank Operations, joined the meeting.

There had been distributed a memorandum dated August 29, 1963, from Mr. Stone, Manager of the System Open Market Account, and Mr. Farrell,

Director of the Board's Division of Bank Operations, suggesting revisions of procedures with respect to allocations of the System Account. The memorandum pointed out that when the present allocation procedures were adopted in March it was indicated that as gold reserve ratios pushed downward it would be necessary to devise new procedures that would be workable even if such ratios should move close to 25 per cent. To date the existing procedures had been working satisfactorily. However, with the combined reserve ratio for all Reserve Banks now in the neighborhood of 31 per cent, and with the fall expansion in note and deposit liabilities about to get under way, it seemed desirable to develop a revised set of procedures for the Committee's consideration. The proposed new procedures, which were set forth as an attachment, were discussed in some detail in the memorandum. In addition, the hope was expressed that before too long the allocation procedures--which now involved the use of high-speed computers--would have developed to a point where, if it should be the Committee's desire, no Reserve Bank would need to show a reserve deficiency on any day as long as the combined ratio for all Banks was at least somewhat above 25 per cent.

During a discussion of the proposed revised procedures, Mr. Marsh explained a minor change that had been suggested since the memorandum was distributed, and agreement with this change was indicated.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the proposed revised procedures for allocating the System Open Market Account were adopted, effective with the reallocation for September 25, 1963. The revised procedures were as follows:

1. Securities in the System Open Market Account shall be reallocated on the last business day of each statement week and of each month by means of adjustments proportionate to the adjustments that would have been required to equalize approximately the average combined reserve ratios of the 12 Federal Reserve Banks based on the most recent available five business days' reserve ratio figures.

2. The morning after each weekly and monthly statement date, the Board's staff shall calculate the reserve ratios of each Bank after allowing for the indicated effects of the settlement of the Interdistrict Settlement Fund for the preceding day. If these calculations should disclose a deficiency in the reserve ratio of any Bank, the Board's staff shall inform the Manager of the System Open Market Account, who shall make a special adjustment as of the previous day to restore the combined reserve ratio of that Bank to the average of all the Banks or to such higher level as may be necessary to eliminate the deficiency in note or deposit reserves. However, such adjustments shall not be made beyond the point where a deficiency would be created at any other Bank. Such adjustments shall be offset against the participation of the Bank or Banks best able to absorb the additional amount or, at the discretion of the Manager, against the participation of the Federal Reserve Bank of New York. The Board's staff and the Bank or Banks concerned shall then be notified of the amounts involved and the Interdistrict Settlement Fund shall be closed after giving effect to the adjustments as of the statement date.

3. If a Bank anticipates that its reserve ratio will fall below 25 per cent on any other day (because of purchases that day for the System Open Market Account or for other reasons), it may arrange with the Manager of the System Open Market Account for an adjustment on that day in an amount sufficient to raise its combined reserve ratio to the average reserve ratio of the 12 Banks combined on the preceding day, or to such point as the Manager of the System

Account and the Bank concerned consider feasible. Such securities shall be allocated to other Banks in order of their ability to absorb the largest additional amount without reducing their reserve ratios below the ratio of the 12 Banks combined.

4. Until the next reallocation the Account shall be apportioned on the basis of the ratios determined in paragraph 1, after allowing for any adjustments as provided for in paragraphs 2 and 3.

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

Messrs. Hexter, Conkling, and Daniels then withdrew from the meeting.

The Chairman called at this point for the usual staff economic and financial reports beginning with Mr. Brill, who presented the following statement on economic developments:

Not very much in the way of new economic information has become available since the last meeting of this Committee, but what evidence there is provides no basis for modifying the staff's appraisal of the economic situation. More of the same seems to be the order of the day.

On the labor front, the unemployment rate edged down slightly in August, but at 5-1/2 per cent it still is not significantly different from a year ago and there continues to be no change in the number of workers suffering from longer term unemployment. Some improvement in the job situation among adult males has been offset, in large part, by continued inability to find enough opportunities for the rising number of younger workers now entering the labor force.

On the production front, the index for August has not as yet been calculated, but present indications suggest little change from the July level. It is encouraging that there appeared to have been sufficient strength in other lines of activity to offset the sharp decline in auto and steel output. It is encouraging also that in recent weeks steel production appears to have stabilized at these reduced

levels and that September auto production is scheduled to increase. How far this carries, however, depends in large measure on the public's reception of the new auto models.

As for prices, scattered reports of increases for some industrial commodities have been balanced by reported declines in others, and the over-all commodity average remains stable at a level little different from that prevailing over the past two years. Unfavorable weather and increased sales taxes contributed to the rise in consumer prices earlier in the summer, along with the usual slow but persistent updrift in prices of services.

Turning to prospective developments, the new survey of business plant and equipment spending plans reported by the Department of Commerce confirms earlier indications that business capital outlays should be rising substantially over the balance of the year, with the fourth quarter rate of outlays expected to be some 8 per cent greater than a year ago. Welcome as this rise in spending would be, one can legitimately express some disappointment about the survey results. For one thing, since last autumn there has been a persistent shortfall in actual as against planned spending. The shortfall has not been very large in amount, but still is a rather unusual development in a cyclical expansion during which neither strikes nor material shortages have inhibited realization of plans.

Second, the anticipated rise would bring total capital spending for the year to a level slightly below that projected by businessmen last spring, and, in fact, only about 2 per cent above the levels projected almost a year ago. In light of the surprisingly strong profit and cash flow picture that has developed this year, one might have reasonably expected some raising of sights by businessmen as to capital requirements, but apparently availability of funds by itself does not carry enough weight in determination of investment plans. Finally, one might note that, in dollar terms, the rise in fixed capital spending over the second half of this year--some $3 billion--is likely to be offset in large part by lower rates of inventory accumulation than in the pre-strike-threat period. Over-all, therefore, the business sector's contribution to further rise in economic activity is not likely to be much greater than earlier this year.

The enigmatic consumer remains a question mark, spending generously--weekly data suggest August retail sales up slightly from July, the third consecutive monthly

increase--but also saving providently. There are some signs suggesting a further moderate diminution of savings, particularly through financial intermediaries, but July data tend to be volatile and certainly what information we have is too fragmentary to permit any conclusion about basic shifts in trends. By and large, nothing suggests any significant deviation in consumer behavior from recent patterns.

The Federal Government's contribution to economic activity may rise more sharply in the fourth quarter, if the military pay raise is approved and becomes effective promptly. The outlook for other types of Federal expenditures, however, seems to be for a continued advance at the pace of recent quarters. Federal spending for goods and services, transfers, interest, and grants-in-aid has continued to rise in step with GNP throughout almost all of the recovery and expansion period since early 1961. This is in contrast to no rise for almost two years after the 1954 recession trough, and to the leveling off after less than a year of the 1958-60 upswing. Federal revenues, however, have been rising as rapidly as expenditures, and the net of the Government's injection and withdrawal of funds has been a moderate deficit position--as measured in the income and product accounts--that hasn't changed much over the past two years. Again, this contrasts with the rapid return to a net surplus position that acted as a drag on the economy in earlier cyclical recoveries. However, merely not making the same fiscal mistake is hardly an adequate substitute for aggressively adopting the right fiscal policies. Tax reduction seems as much a necessity today as it was last winter Unfortunately, monetary policy has to be formulated today in light of the absence of such fiscal stimulation to the domestic economy.

Mr. Koch presented the following statement on financial developments:

To phrase my text for today, let us beware of overemphasizing the importance of small and gradual changes in monetary policy, even sometimes those cumulated over a considerable period of time. I come back from a four-week vacation to find a policy of monetary ease lessened slightly

again, for the fifth time since late 1961. And yet I find essentially unchanged the more fundamental indicators of monetary policy considered as a group, namely, the course of bank reserves, bank credit, the money supply, both narrowly and broadly defined, and even interest rates, if one excludes short-term rates, which probably have only minor effects on over-all economic activity.

This combination of policy changes and actual events may have been exactly what was sought. But it has probably been more a reflection of the basic forces of the demand for credit and capital and the supply of real saving rather than of monetary policy. I'm afraid only a loose relationship can also be found to have existed between recent changes in monetary policy and international capital movements.

Looking at the factual evidence to support these obviously somewhat overdrawn conclusions, the money market has firmed a bit, at least since late July, although not perceptibly since the Committee's last meeting. Free reserves have ranged around $100 million, as compared with about $150 million earlier. Member bank borrowings from the Reserve Banks have averaged a little over $300 million a day, unchanged from July. The Federal funds rate has generally been at or just under the new 3-1/2 per cent discount rate. New York City commercial bank lending rates to Government securities dealers have been most often at 3-3/4 per cent, and the 90-day Treasury bill rate has fluctuated between 3.35 and 3.40 per cent.

Bank reserve expansion, on the other hand, has proceeded apace, despite the slightly firmer tone of the money market. Required reserves behind private deposits continue to average about $100 million above the guideline used in the staff memorandum, which includes a 3 per cent secular growth rate.

The money supply, narrowly defined, has probably risen somewhat again in early September after having declined a little in August. Thus far this year, growth has been at an annual rate of about 2-1/2 per cent, as compared with 1-1/2 per cent in 1962 as a whole.

Time deposit growth at commercial banks has quickened a little since the July action raising maximum rates payable on certain of these deposits, with the growth being especially sharp in the case of negotiable time certificates of deposit. The money supply, including time deposits, continues to increase at a 7 to 8 per cent annual rate.

As for bank credit expansion, the pace in the third quarter is off a little from earlier in the year, but this

may be due largely to the changed timing of Treasury financing. Normally, Treasury financing in the summer occurs in July, whereas this year it occurred in June. Bank acquisitions of municipal and Government agency securities continue large, as do real estate and consumer loans, with business loans experiencing a somewhat slower rate of growth thus far this year than in 1962--about 5 per cent compared with 9 per cent.

Business financing through the capital markets, as well as through the banks, has been seasonally less this summer than earlier. These business financial developments reflect somewhat larger flows of internal funds as a result of better earnings and higher depreciation accruals and only a moderate rise in capital spending.

Although on balance the major impact of a slightly less easy monetary policy has thus far been on money market conditions and short-term rates of interest, there may be beginning to be some spillover effects on longer term rates and even credit availability. Long-term Government, corporate, and municipal bond yields are now all between 1/8 and 1/4 of a percentage point above their lows earlier in the year. Yields on intermediate-term Governments have experienced a somewhat greater rise. Even mortgage rates appear to be under less downward pressure than they were earlier. This course of longer term rates has occurred in the wake of rather large System purchases of Government coupon issues in August. It has been accelerated by the current large Treasury advance refunding, and there are signs that even with larger cash flows, some corporations may be deciding that this is a good time to borrow long-term.

Having opened my remarks by noting the relatively small changes in the basic indicators of monetary policy that have resulted from the gradual lessening of monetary ease that has occurred, not only just this summer but indeed since late 1961, let me conclude by expressing a note of caution about this conclusion. Granted that in a private economy as large and varied as ours, monetary policy can normally be only a marginal and a lagging influence on financial and economic developments, we may be entering a period when such an influence can become quite important.

Bank liquidity has been decreasing for some time now, and longer term interest rates have risen a little. In these circumstances, further reduction in monetary

ease could unduly dampen domestic activity in general and investment in particular. In any case, the timing and magnitude of the advance refunding and the current market readjustments that are occurring as a result of this action no doubt preclude any significant shift in policy throughout most, if not all, of the period between this and the next meeting of the Committee.

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

On the basis of the tentative and fragmentary weekly data, the deficit for August apparently was in the neighborhood of $250 million, or about the same as that for July, if both figures are adjusted for special transactions (including the reversal of window-dressing in July).

A deficit of that magnitude would be somewhat lower than the monthly averages for either the first or the second quarter; and it would be very much smaller on a seasonally adjusted basis since the first and second quarters are seasonally favorable but the third quarter is seasonally unfavorable.

The trade balance does not seem to have improved--on the contrary, in July the trade surplus declined substantially. The service balance, before seasonal adjustment, certainly has deteriorated in view of the travel season. There is no reason to assume a significant reduction in Government expenditures abroad; thus, the improvement would seem to have been concentrated mainly in the capital sector.

Within this sector, there does not seem to have been much change on short-term account. The rise in U. S. short-term rates has not altered rate differentials in relation to major financial centers abroad: Euro-dollar rates have increased virtually as much as U. S. rates; the covered rate differential in favor of U. K. Treasury bills again exceeds 1/4 of 1 per cent; and while the covered differential in favor of Canadian Treasury bills, despite the rise in Canadian bill rates, has been virtually eliminated by a widening of the forward discount on the Canadian dollar, the differential in favor of Canadian financial paper continues to attract U. S. funds. In fact, according to the admittedly fragmentary reports collected by the New York Reserve Bank, the outflow of money market funds, almost exclusively to Canada, amounted to $55 million gross and $40 million net during the past three weeks, or about as much as during the least favorable three-week period last spring.

Thus, we may guess that the improvement occurred in the long-term sector. Since nothing has happened to diminish the outflow of direct investments, it seems likely that the improvement was in portfolio investments and long-term bank lending. This assumption seems confirmed by the virtual cessation of scheduling of foreign bond issues in the New York market, following the announcement of the equalization tax proposal. The flight of foreign and domestic capital, predicted by some domestic and foreign bankers, has failed to materialize--as witnessed by the recent events in the stock market. In fact, as Mr. Coombs has suggested, the effect of the tax proposal on capital outflows may well have been greater during the past and present period of uncertainty than it will be once the tax is enacted. Right now, nobody knows for sure what transactions will be subject to the tax retroactively, and therefore it is virtually impossible to take measures to avoid the tax. Once the tax provisions have been settled, the inevitable loopholes will greatly reduce its effectiveness.

Economic expansion appears to continue in foreign developed countries. This permits us to expect a further rise in U. S. exports but also further outflows of direct investments to those countries. In contrast, financial chaos continues to reign in some less developed countries that are among the best U. S. customers, and especially in Brazil. This not only clouds the future of U. S. exports to those areas but also raises the prospect of additional calls for U. S. Government assistance.

Two recent statistical reports have shed some light on recent movements of U. S. capital. The first is a confidential report on dollar holdings of European countries collected by the Bank for International Settlements. The figures are significant mainly because they show that, contrary to our fears, our figures on U. S. short-term liabilities to and claims on Europeans are pretty close to the European data. The Euro-dollar market has made for some changes in the distribution by countries but shows about the same net balance for Europe as a whole as the figures collected by the Federal Reserve Banks.

The second report is the survey of U. S. foreign investments published in the August issue of the Survey of Current Business. The stock market decline of May 1962 improved the net international asset position of the U. S. during 1962, since foreign holdings in the U. S. are mainly in the form of shares while U. S. foreign holdings are mainly direct or fixed-interest investments. Partly in consequence, although our payments statistics showed a deficit of $3-1/2

billion in 1962, our net asset position actually improved by $3 billion, surpassing the level reached at the end of 1957. While these figures give no reason for complacency, they should remind us that we exaggerate the magnitude of the U. S. payments deficit if we fail to consider changes in our assets as well as in our liabilities.

Equally important are the figures on our total investments in foreign developed countries. If we count as gross investment abroad not only our recorded capital outflow but also reinvested earnings of foreign subsidiaries and, say, half of the usual depreciation allowances of foreign branches and subsidiaries, total U. S. investment in Canada, Europe, and Japan amounted to $2.8 billion in 1962--a figure equal to 80 per cent of our total deficit. If it were possible to eliminate that investment without harming U. S. exports--or, as one member of this Committee recently suggested as an alternative, to raise U. S. exports by the amount of that investment by means of some tying mechanism--those short-term capital outflows that reflect bear speculation would presumably cease, if not be turned into an inflow. Moreover, if it were possible to divert those funds to domestic investment, this would increase gross investment in the U. S. by 3-1/2 per cent, GNP probably by more than 1 per cent, and employment perhaps by 1/2 of 1 per cent. Thus, U. S. gross investment in foreign developed countries may well hold the key not only to our payments deficit but also to our lag in domestic growth and employment. How to find the best way to reduce that investment and especially how to circumscribe the role of monetary policy in that endeavor--this is another story.

The Chairman then called for the go-around of comments and views on economic conditions and monetary policy beginning with Mr. Hayes, who presented the following statement:

There has been no major change in the business situation since our meeting three weeks ago. The upward movement has been broadly based but moderate in pace, and the prospect is for a similar tendency over the coming months. Removal of the rail strike threat has of course been a significant favorable development. Retail trade continues to be a bright spot in the economic picture; and the good clean-up of 1963 auto models, together with indications of strong consumer buying intentions, augurs well for

auto sales in the new model year. Plant and equipment outlays, according to the latest survey, should show good gains in the second half of the year, but are no higher than estimates made three months ago. Declines in leading indicators in the residential construction area may well turn out to be only an erratic statistical movement. Underlying strength in this field is suggested by the rising trend of new household formations, lower apartment vacancy rates, and ample mortgage credit.

Signs of upward price pressures, in addition to specific influences pushing up food prices, have become more noticeable in the past two months. However, it is certainly too early to interpret these developments as an inflationary break-out from the narrow range of major price indices over the past three or four years. Stock market prices indexes have touched new highs, and volume has picked up, suggesting that there is renewed public interest in equity shares. This rebound of activity and optimism is, no doubt, rooted in the brighter outlook for profits against the background of better business prospects and the expectation of a tax cut this year. I find cause for watchfulness rather than for concern in recent commodity price and stock market developments.

Credit conditions are also little changed in the past three weeks. Real estate and consumer loans have continued to show strength, while business loans have remained sluggish. With corporate liquidity still high, corporate funds have tended to flow into the money market in record volume, helping the dealers to finance their inventories. Over-all nonbank liquidity seems ample. As for bank liquidity, the statistical ratios point to some downward drift in recent months, to which our own policies have doubtless contributed. Yet despite the discount rate increase, the related firming of market rates, and some increase in the pressure on bank reserve positions, the banks are still aggressively seeking new loans, particularly in the mortgage and foreign areas. The advance refunding has had some downward influence on short-term market rates. The persistently heavy flow of savings has acted as a stabilizing influence on long-term rates in the face of the System's monetary moves--although the advance refunding announcement has caused some rise in long-term rates in the last few days. The deflection of investment from abroad resulting from the interest equalization tax proposal is likely to add moderately to the demand for domestic longer term investments.

Turning to the balance of payments, there is some faint cause for encouragement in the declining tendency of the deficit over the first four weeks of August and the likelihood that the third quarter deficit--even after adjustment for special window-dressing factors around the end of June and early July--will show a pronounced improvement over the very poor second quarter results. The dollar has been performing a little better in the foreign exchange markets, and it may well be that the capital account is already showing the favorable effects of higher interest rates and reduced reserve availability in this country, together with the sharply inhibiting effects of the interest equalization tax proposal on new foreign issues. On the other hand, the outflow of short-term funds to Canada has been resumed since the Canadian discount rate rise of August 12 and the subsequent upward adjustment of Canadian money market rates.

Recent trade developments have been less encouraging than the capital account. Imports rose in July, and as the business expansion goes on, we can hardly hope to avoid further import increases. At the same time, exports declined in July. With the over-all deficit still running at a dangerously high level, we cannot afford to give any less weight than we have been giving to international considerations. It is of course vitally important that we do show a real improvement in the balance of payments in the third and fourth quarters, if we are to build confidence that we have been taking appropriate action, and if we are to avoid a burgeoning of fears that direct controls will be imposed--with all that this would mean for the dollar's standing.

Since the Treasury is in the midst of an important advance refunding operation, we should aim to promote stability in the money market over the next week or ten days. Thereafter it would be desirable, in my judgment, to take advantage of the somewhat greater scope for action provided us by the steadily improving domestic business situation, and to seek a slightly greater degree of firmness in money market conditions and especially in Treasury bill rates. It seems to me that this would be well worth doing in order to make it clear that we "meant business" when we raised the discount rate to 3-1/2 per cent and that we intended this move to find pretty full reflection in market rates within a reasonably short span of time. In other words, I would hope that the 90-day bill rate would move into a range close to 3-1/2 per cent--perhaps both above and below that figure. Our

efforts to achieve firmer bill rates should be helped by the current relatively high level of dealer inventories and the Treasury's avowed intention of relying heavily on bills for their cash financing needs over the coming months. However, because of the current high level of cash balances, they do not expect to be able to help in this way in the near future. I would hope that higher rates could be achieved without any very substantial reduction in free reserve levels; but I would let free reserves drop to the extent needed to attain the slightly firmer tone I have suggested as a primary objective.

If this policy receives the Committee's support, the second paragraph of the directive might appropriately be modified to reflect the Committee's wish to see a slightly greater degree of firmness in the money market after the Treasury financing is completed.

Looking a little further ahead, I am wondering whether we are approaching a time when the Board might wish to consider a reduction in reserve requirements as a means of meeting a portion of seasonal reserve needs with a minimum of downward pressure on short-term market rates.

Mr. Ellis reported that the economic climate in New England did not seem to have changed greatly during the summer months. Employment, production, personal income, and consumer spending were running slightly below the national trends, and only construction activity was outpacing year-ago figures more decisively than the improvement nationally. The summer vacation business had shown a substantial gain over the year-ago experience, with the index of tourist attractions showing a 13 per cent gain in attendance in July. However, resort facilities reported a noticeable decline in business done in Canadian currency, apparently reflecting the discount on the Canadian dollar.

Turning to the banking picture, Mr. Ellis said that during July and August First District weekly reporting member banks had been readjusting their positions after the fairly rapid surge of loan demand in May and June. They had sold off about a quarter of their Government securities and, despite some deposit outflows, were able to expand their loan portfolios and buy more municipals. Large commercial banks in Rhode Island and Vermont had recently raised their rates on savings deposits to 4 per cent to meet competition.

With respect to monetary policy, Mr. Ellis said two questions were paramount in his own analysis. One question was whether the recent discount rate action was having an effect on short-term capital outflows, and the other was how the domestic economy was faring in light of the recent changes in reserve availability and interest rates. On the first question, it would be difficult to get a satisfactory answer since one could not be sure what would have happened in other circumstances. It was known that there had been some increases in Canadian, British, and Euro-dollar rates, but the short-term capital movement did not seem to have increased. The effect of the interest equalization tax proposal on capital flows could not be separated from other factors. On the second question, Mr. Ellis was inclined to be fairly optimistic about the course of the domestic economy. Output had increased during the summer in the face of the steel inventory reduction. Retail demand seemed strong,

personal income was up, reports on profits were favorable, stock market prices had moved to a new high, the construction business was better than expected, and the outlook for fall business was reported to be good. Given these factors, a stronger demand for bank credit might be anticipated this fall.

As to policy for the next three-week period, Mr. Ellis said that the even-keel concept would seem to have pertinence during the period of Treasury financing, which would preempt most of the forthcoming period. Thereafter, there would appear to be some leeway available for monetary policy. He would meet fully the reserve needs occasioned by seasonal expansion, but perhaps with some reluctance in order to support any tendency toward firmer rates. A zero net free reserve figure, plus or minus, would be acceptable as a target, with uncertainties resolved on the side of less ease. He would be willing to see the bill rate in a range from 3.40-3.50 per cent, with Federal funds regularly at 3-1/2 per cent. Such a course would amount in effect to a slight further shift toward less ease, and logically a change in the policy directive would seem to be indicated. At times in the past, however, he recognized that the Committee had preferred to avoid issuing directives that called for delayed shifts of policy following the completion of pending Treasury financing operations. This led him to conclude that the Committee could afford to continue the present policy directive for another three weeks,

after which time there could be a further appraisal of the wisdom of following a slightly firmer policy.

Mr. Irons said that most indicators of Eleventh District economic activity, including industrial production, employment, and construction either were inching upward or holding at a high level with seasonal coloration. Construction activity continued to be strong. In the area of mortgage financing, brokers and mortgage men who are regarded as leaders in the District do not admit that there has been any deterioration in the quality of credit. However, they agree that there has been a lengthening of maturities and lower down payments. They also indicate that there has been too much mortgage money available, and rather than reduce rates, there is a tendency to extend terms and the mortgage coverage.

Turning to the District banking picture, Mr. Irons said that loans were up in the last three weeks, with most of the increase in the commercial and industrial loan categories although real estate and consumer loans had also increased. District banks had not heretofore been too active in mortgage financing, but there appeared to be some tendency in that direction. Demand deposits were up, particularly those of individuals, partnerships, and corporations, and time deposits also had increased. Some of the banks in the District had been quite active in Federal funds, particularly on the buying side, and had been running fairly high figures on funds

purchased. Borrowing from the Reserve Bank had been nominal. On the whole, District banks were rather aggressively looking for opportunities to lend. They were not as liquid as they had been, perhaps, but they were reasonably liquid.

Mr. Irons said it seemed to him that monetary policy was definitely limited to an even-keel position for the next two weeks, in view of the Treasury advance refunding operation. Rather than to try to split off a few days at the end of the forthcoming three-week period, he would recommend no change in policy during the period of Treasury financing and until market churning had ceased. Then, at its next meeting, the Committee would be in a position to consider whether any change in policy was appropriate. If there were any deviations from an even keel, he would prefer to see them fall on the side of a little less ease, but in general he would suggest an even-keel operation over the next three weeks. This would infer a bill rate somewhere around 3.40 per cent, Federal funds trading at 3-1/2 per cent, dealer rates from 3-5/8 to 3-3/4 per cent, and free reserves varying between $50 and $100 million, though without too much emphasis on that figure. The tone and pattern of the market was more significant than a free reserve figure. He would not change the policy directive.

Mr. Swan said there had been little change in the general economic picture in the Twelfth District during the past three weeks.

As preliminary data indicated at that time, the unemployment rate rose slightly in July as additions to the labor force outran a slight increase in total employment. Final department store sales figures showed an increase from June to July, and apparently department store sales held up well in August. In the lumber industry, the anticipated decline in prices upon cessation of the labor dispute had occurred, with both lumber and plywood prices declining sharply by the end of August.

For the three weeks ending August 28, weekly reporting member banks showed an increase in total loans, but the gain was less than half as large as during the comparable period a year ago. Real estate loan portfolios continued to rise; the smaller increase in total loans than a year earlier was attributable to a decline in business loans. There was still no particular indication of a significant pickup in business loans. Major banks in the Twelfth District remained substantial net sellers of Federal funds; they had continued in that position last week and were expected to be on the same side during the current week.

Turning to policy, Mr. Swan said it seemed that in view of the Treasury refunding an even-keel policy was called for. Further, he saw nothing in the domestic business or international situation that would indicate the desirability of a change in present policy before the next meeting of the Committee. Accordingly, his preference

would be to maintain the present position through the entire three-week period, both because of the Treasury financing and the general economic picture. He agreed substantially with the target figures indicated by Mr. Irons. If the bill rate returned to a level of about 3.40 per cent, he would consider that as being within the scope of present policy, but he would doubt that an increase to 3.50 per cent should be regarded as falling within this general definition. He hoped the existing general market position could be maintained, with free reserves around the $100 million level.

With respect to the policy directive, Mr. Swan said he would suggest no change, except perhaps the insertion of a phrase such as "in view of the current Treasury refunding" in the first part of the second paragraph.

Mr. Deming reported that business sentiment in the Ninth District, as measured by the Reserve Bank's opinion survey of early September, was quite optimistic, with three out of four respondents seeing improvement in the near-term future and most of the remainder looking for continuation of present high-level activity. Only 6 per cent of the respondents saw a possible decline ahead. This sentiment undoubtedly reflected both a strong agricultural situation and a modestly expanding nonfarm sector. The 1963 wheat crop was the largest since 1958, and a near record. Both corn and soybeans were very good. Altogether, total crop output might be second only to 1958. Range and pasture

conditions were favorable and conducive to normal fall livestock marketings. Nonagricultural employment was expanding modestly, and hours worked in manufacturing in July averaged 42.1 per week, higher than the national average. Bank debits were up strongly from year-ago levels. Electric power use in industry was sharply higher in July, and personal income in that month was 5 per cent ahead of a year earlier. The major area of weakness continued to be mining.

The banking picture contrasted rather sharply with the overall economic situation in the District. In general, loan, investment, and deposit trends in the first half of 1963 were strongly upward, after allowing for seasonal factors. In July, bank credit behaved about seasonally, but deposits declined more than seasonally, reflecting mainly the reduction in Government balances and apparently a consequent outflow from the District. In August, the deposit trend of July continued and was accentuated as interbank balances were reduced along with Government deposits. Time deposit growth, however, was fairly strong, and ordinary demand deposit behavior was about normal. Bank credit at country banks was about as expected, but at city banks loans dropped rather sharply and contraseasonally, reflecting weakness in most loan categories and particularly in business loans. This movement seemed to be carrying over into early September and was accented. City bank investments were expanding, but not enough to offset the loan decline.

As to policy, Mr. Deming expressed the view that with an even keel indicated for most of the forthcoming three-week period, it would be well to follow such a course for the entire period. He was not sure, however, exactly what was comprehended by an even-keel concept during the three weeks. He would like to see the bill rate return to the 3.40 per cent level, with free reserves around $100 million, but he was not certain that both of these objectives could be accomplished. If not, he would be inclined to let the free reserve level drop a bit to insure that the bill rate did not fall significantly. While he would not attempt to push the bill rate back to 3.40 per cent just for the sake of attaining that level, it would be undesirable if the rate fell much below the present level. In view of his policy suggestions, quite obviously he would see no reason to change the current economic policy directive.

Mr. Scanlon reported that business activity continued at a favorable level in the Seventh Federal Reserve District and was generally expected to show further improvement. Retail sales, at least of nondurables, appeared to have reached another new high in August, while unemployment insurance claims remained at a low level. Production of steel probably reached its low in mid-August and was now rising. Producers of autos and trucks were highly confident that the new models soon to be offered for sale would be accorded a favorable reception by buyers. Orders for most types of capital

goods and construction contracts had been at a high level, indicating some further rise in activity in these lines.

Department store sales in the District apparently reached a new seasonally adjusted high in August. The rate of net inflow of savings to banks and savings and loan associations in the District slackened appreciably in July. Withdrawals, while above the preceding month and July of last year, were generally in line with earlier months this year.

Mortgage interest rates appeared not to have been affected yet by any firming of money markets. A Reserve Bank survey showed some further easing of rates in the Chicago area in July. The average effective rate on new home mortgages was 5.8 per cent compared with 6.0 per cent in July of last year.

Total credit at District banks declined in August as holdings of Government securities were reduced rather sharply--about $250 million at Chicago banks since the end of July. Despite a reduction in dealer loans, total loans rose moderately, as a result of increases in both the business and consumer categories. Recent strength in business loans reflected, in part, a large credit in the chemicals category recorded early in the month. Durable goods manufacturers and trade firms repaid bank loans on balance in August. Demand for non-real estate farm loans at agricultural banks was very strong in July, partly because of a heavy volume of purchases of feeder cattle

by farmers and partly because of renewals necessitated by delayed marketing of fed cattle, drought conditions in some areas, and other factors. The large Chicago banks reported a net decline in loans since early August. This development, coupled with further sales of Treasury bills, had contributed to an easier reserve position. These banks had been able to cover their needs fully in the Federal funds market, and borrowing by other District banks had been at a low level.

Mr. Scanlon concurred in the view that an even-keel policy was called for during the next three weeks. He would not be disturbed by a short bill rate in the 3.40 per cent area, but in view of the possibility of downward pressure during the next few weeks, he would not press to achieve that rate. In the present circumstances, he would favor no change in the directive, and he would not change the discount rate.

Mr. Clay expressed the view that during the next three weeks it would appear logical to pursue essentially the same policy that had been adopted at the Committee meeting three weeks earlier. The most immediate reason for not changing policy was the Treasury financing operation that would be under way during the period. Quite apart from Treasury financing, however, he felt it would be in order to continue the same policy. That policy posture constituted the

implementation of the change that was initiated with the discount rate action in mid-July, and the System should continue to carry out the decision represented by that action.

For the period ahead, Mr. Clay continued, pursuit of this policy would appear to call for maintaining a degree of money market firmness represented by a Treasury bill rate of about 3-3/8 per cent. The current directive also called for accommodating moderate expansion in bank reserves, and that also should be continued. In order to facilitate the attainment of these objectives, the Account Manager should conduct operations in various maturities as necessary, recognizing that such operations might be limited by the Treasury's financing activities in the interval ahead. The discount rate should be left unchanged. With reference to the directive, consideration should be given to rewording the second sentence of the first paragraph, in view of money supply developments in August. The last paragraph of the directive could be left unchanged.

Mr. Wayne said that signs of improvement in Fifth District business were definitely more numerous than a few weeks earlier. Although some of these favorable items described conditions a number of weeks earlier, they added a significant impression of strength to the current picture. In July, for instance, seasonally adjusted nonfarm employment passed the five-million mark for the first time as jobs in trade, contract construction, services, and

government all reached record levels. Bank debits, manufacturing man-hours, and cigarette production were also at all-time highs. In August, rates of insured unemployment were mostly well below the national average. Department store sales, at a high level in July, showed further improvement in August. General business sentiment, as revealed in the Reserve Bank's latest survey, remained moderately optimistic. Manufacturers reported small gains in new orders, order backlogs, shipments, wages, and prices, with employment and hours virtually unchanged. The agricultural outlook, particularly for pastures and late crops, had improved slightly as a result of scattered rains. Loan demand continued strong in the District, perhaps a little stronger than in the nation as a whole.

On the national front the most important news seemed to be no news of any significant weakness in the vacation month of August. The temporary solution of the rail dispute had removed one potentially serious roadblock, and civil rights disturbances apparently had not had any significant effects on business activity generally. On the positive side, the little information available for August seemed to indicate that the economy continued to operate at a high level with perhaps some increases in particular areas. The continuing strength in prices after significant rises in July apparently indicated considerable strength in demand. Retail sales seemed to be holding their own at a high level. Purchasing agents noted a small rise in new

orders, with production and employment remaining about steady. With almost no definite movements to serve as guides, the sustained strength of recent weeks could only be regarded as a possible indicator of a satisfactory rate of activity in the weeks immediately ahead and maybe a little better than seasonal rise during the fall months.

In the policy area, Mr. Wayne felt that the Desk had done a good job in carrying out the current directive in the face of considerable difficulties. He concurred in the view that an even keel was indicated for the next two weeks, and in view of general conditions he saw no reason to change policy during the entire three-week period. As to targets, he agreed generally with the suggestions of Mr. Deming. Accordingly, he would renew the present policy directive, except for such change as might be deemed advisable in recognition of the Treasury financing. He would not change the discount rate at this time.

Mr. Robertson presented the following statement:

> I am sure that all of us have been studying the recent reports on business developments with special care, looking for the first clues as to the trend of business this fall--now that we have passed the traditional Labor Day jumping-off point. I have been doing so, but it seems to me the flow of evidence is inconclusive at this point. The fall business expansion is still more a matter of hope than anything else, although a few more weeks of figures may remove some of the doubts that now exist. I have watched particularly closely the trend of prices in recent weeks, for the succession of price increases being reported was a source

of real concern to me. Our general price stability is one of the key achievements of recent years, and one that we are going to have to maintain if we are to achieve any orderly resolution of our domestic and international problems. If a general price upcreep were to start, I think monetary policy would have to be prepared to do its part to resist. Fortunately, the latest and most comprehensive information on wholesale prices suggests that price increases and decreases are still essentially offsetting, and that means to me that we still are in a period when monetary policy can be broadly stimulative in the interest of promoting greater employment of our resources.

I note with some satisfaction the apparent (though inadequately explained) improvement in our over-all balance of payments during the past two months, and I think we ought to watch carefully to judge both the sources of that improvement and how long it may continue. I doubt that little, if any, of this improvement can be attributed to our changed monetary policy, and I would not think any further change in policy for balance of payments reasons would be in order until the extent and duration of the recent improvement is more clear.

I am troubled by some of the domestic financial consequences that may be developing as a result of both our actions and the debt management operations of the Treasury. I refer to the higher interest rates and more cautious tone that have appeared in the capital markets, and the stepping up of reserve pressures on banks to the point where they have had to make substantial sales of Government securities. I think it is unclear at this juncture how far such adjustments will proceed, but at some point they must surely begin to alter lender and investor attitudes towards additional requests for loans, and at that point our policy of "less ease" will, in my judgment, have gone too far. Indeed, we may have passed that point already, although it is very difficult to judge. At the very least, I think we should hold our policy course steady over the next few weeks, watching carefully for cumulative consequences of the firmer money and capital market conditions that have been created. The huge Treasury advance refunding, of course, is itself a factor tightening long-term markets, and should lead us to maintain "even keel" considerations for the full period of time during which the market is involved in this operation. And in this case it is my view that "even keel" should be judged more in terms of reserve positions, Federal

> funds rates, and dealer needs than by the bill rate, which may be selectively depressed by reinvestment demand from investors uninterested in the advance refunding offering. A selective remedy for such downward rate pressure is readily at hand in the form of the sale of additional bills by the Treasury. I think that is the appropriate tool for doing any tinkering that is to be done with the bill rate at this juncture. I would not want to see us again use the general tool of increased reserve pressure to squeeze bills out of the banking system, as we have done over the past six weeks. I think the full consequences of that course of action are not yet known to us, and we may well regret the eventual effects upon bank and public liquidity when all the facts are in.

In conclusion, Mr. Robertson said that he would not favor changing the policy directive. Neither would he favor changing the discount rate at this time.

Mr. Shepardson said that economic developments seemed generally encouraging. However, the crawl of prices concerned him. Admittedly, it was not a great crawl, but it was a movement in the wrong direction if one expected to achieve economic growth and greater utilization of resources. While he did not know how to measure the impact of the recent change in the minimum wage, it certainly would be conducive to holding up prices. Whatever effect it might have from the price standpoint would be in the wrong direction.

To repeat, he was concerned that if there continued to be a crawl in prices, this would affect adversely both the trade balance and the growth of the domestic economy.

However, in light of the Treasury financing, it seemed appropriate to Mr. Shepardson to continue the present monetary policy at

this time. He was inclined toward a position such as Mr. Ellis had outlined, with the understanding, however, that because of the Treasury financing, the present policy should be continued for the full three-week period ahead. Accordingly, he would favor renewing the policy directive without change.

Mr. King said that he agreed with the remarks of those who favored no change in the policy for the forthcoming three-week period. He doubted the necessity of changing the policy directive to make reference to the current Treasury financing operation. At times such a reference was necessary, but not on every occasion when an even-keel policy was to be followed. He also felt there should be no change in the discount rate. As he saw it, all aspects of present policy should be continued.

Mr. Mitchell said that he thought no change in policy was the course indicated for the coming period. He felt that the Desk should not fight a modest lowering of the bill rate, because of technicalities that might produce pressure. On the other hand, if market forces produced a rise in the bill rate, he would be agreeable to seeing the rate move back up to 3.40 per cent.

Mr. Hickman commented that the flow of statistical information since the last Committee meeting had been meager, but on the whole had tended to support the forecast of a quiet August, followed by renewed strength in the autumn. In the Fourth District in August, underlying

strength was evidenced by brisk department store sales and by the continued large volume of residential building. A small increase in unemployment in the District was limited to auto and steel centers.

The pickup in steel orders, the first indications of which were noted at the previous Committee meeting, had strengthened in recent weeks, at the same time that ingot output appeared to be bottoming out. It was evident that the end of the reaction phase in steel was near, with a fresh demonstration of the resilience of the economy in having absorbed the steel downdrag.

When the steel industry had completed its turn, and when 1964 autos became available for sale, there might well be a question as to whether the term "moderate" business expansion would continue to be appropriate. A full-blown expansion similar to those experienced during the 1950's could possibly be in the making. Any such development would imply, either as cause or effect, a significant renewal of rising commodity prices. So far the latter had not occurred, but recent price developments had been showing some faint signs of an upward stir. Paper had now joined steel, nonferrous metals, rubber tires, and cigarettes on the up side. The industrial component of the wholesale price index had edged up by a fraction of an index point in each of three successive months through July, and an additional slight nudge to prices might follow the recent statutory rise in the

minimum wage. Altogether, the price front would bear watching, although it would be premature to conclude that a new phase had set in.

It seemed to Mr. Hickman that monetary policy had done about all that could be expected of it over the past three weeks, and that the Desk had done a skillful job. Since the discount rate action, i.e., in the period from July 17 through August 28, total loan demand at reporting banks had been stronger than in recent years, and with their present reserve positions, banks had been forced to liquidate investments to a greater extent than usual. Insofar as this greater-than-seasonal loan demand continued, he would favor allowing the pressures to be reflected in the market. This might mean a level of free reserves moderately below recent levels, and a growth of actual required reserves below present staff targets.

It should be kept in mind, Mr. Hickman added, that price stability could no longer be taken for granted, that the economy was poised for a possible takeoff, and that the volume of liquid assets held by the public continued to rise vigorously and bore the highest ratio to GNP since 1958.

Mr. Hilkert said that since the previous meeting of the Committee, Third District business conditions had improved slightly and tightness had become more evident on the banking scene. But economic conditions had not improved sufficiently to help the District's lagging rate of economic growth.

Unemployment claims continued well below the totals of recent years, and unemployment had decreased over the summer, but half the District's labor markets still had unemployment rates higher than the nation's. Some increases in output, evidenced by greater-than-seasonal increases in electric power consumption in the District's manufacturing industries, had not been reflected in manufacturing employment or in the workweek. Construction contract awards had failed to exceed 1962 levels, while doing so nationally. Department store sales in the latest four weeks improved a bit over 1962, but not enough to change the Third District's year-to-date deficit of one per cent.

Conditions at Third District banks had tightened during the past three weeks. Basic reserve positions were consistently on the minus side, and District banks lost a little over $100 million in deposits. Business loans fell by $8 million, thus contributing to a total decline in these loans of $40 million since the beginning of the year. Investments were also off, and the total of loans and investments fell by $17 million.

Mr. Patterson said that if the latest statistics for the Sixth District showed anything new, it was the accumulation of additional evidence to confirm the renewed vigor in economic expansion that began to be evident toward the latter part of the summer. The expansion was not of boom proportions, and was not shared equally by all areas of the District, Nevertheless, it had been a pleasant surprise to some persons who were expecting a slowdown during the

last half of 1963. Apparently, the District's economy was performing slightly better than the nation's.

Construction, both residential and nonresidential, was one of the brightest spots. A greater-than-usual part of residential construction was taking place outside the major metropolitan areas. In the nonresidential category, the impact of the expanded space program was beginning to be felt with the awarding of a substantial contract for the construction of a missile test center in Southern Mississippi that might absorb some of the workers released by completion of a $125 million oil refinery in the same area.

Manufacturing employment in the District was rising and retail spending had moved up. Although fall harvest activity was still light, larger-than-usual crops of cotton, peanuts, and corn were expected. There would be a bumper crop of pecans.

The step-up in economic activity was reflected in the latest banking figures. Incomplete data suggested that total bank credit rose in August, with substantial loan increases in Florida and Georgia. With total deposits, reserves, and excess reserves up and member bank borrowing off, there were no signs that recent Federal Reserve policy had resulted in any credit stringency within the District.

Mr. Shuford reported that the economy of the Eighth District had continued to expand during the summer months. Employment in the

major metropolitan areas had risen about 4 per cent since last spring, and there was a marked rise in the industrial use of electric power. Other indicators also had evidenced what seemed to be a good solid growth in the economy. Nationally, there had been a marked rise in business activity that began early this year and appeared from preliminary figures to have continued into August and perhaps early September.

Mr. Shuford said he was inclined toward the view that the economic improvement had been facilitated by the degree of availability of bank reserves and the monetary expansion that occurred last fall and in the first part of this year. Over the past year the System had been able to make some contribution both to the high level of domestic business activity and the balance of payments problem; the total demand for goods and services had been stimulated or at least facilitated by bank reserve and monetary expansion at moderate rates. At the same time, while it was too early to judge, it appeared that the rise in short-term rates had, to some degree, made a contribution from the standpoint of the balance of payments problem.

Insofar as current policy was concerned, Mr. Shuford said he would favor no change in view of the Treasury financing. He would like to see the short-term rate at about the level that had prevailed in recent weeks--somewhere around 3.37-3.40 per cent. While monetary

expansion might appropriately be more moderate than last fall, it should be adequate enough to support a continuation of the business improvement that had been experienced so far this year. He would not favor any change in the discount rate at this time, and he saw no reason to change the policy directive.

Mr. Balderston said that certain of his own concerns had been set forth by Mr. Hickman and that he would also like to mention two others. One was the continuing tendency to put savings and other resources into mortgages, especially for the construction of income-producing property. Of the total outstanding mortgage debt of $263 billion, which had been rising at a monthly rate of about $2 billion, the debt on one-to-four family houses was now about $175 billion. One indication of a lowering of lending standards that had attracted the attention of Mr. Fisher of the Board's research staff was that in July one-fourth of the conventional mortgages on new single-family dwellings were for terms of 25 years or more.

Mr. Balderston went on to say that his other concern was over the rail strike issue. The country may have felt some sense of relief in the postponement of the strike. However, the postponement was accomplished only at the expense of interference with the process of collective bargaining, which might lead eventually to interference in price setting and other matters. In his view, there were worse things than a strike, and the strike now remained for settlement during the winter when any interference with the movement of coal was so important.

The central issue was how many jobs the union was willing to give up as the result of automation, and thus far no criteria for the settlement of that issue had been provided. Thus, Mr. Balderston said, the exuberance of the moment must be tempered by thoughts of a deterioration in the quality of lending and by what might prove to have been a misstep in the settlement of a labor dispute.

As to policy for the forthcoming period, Mr. Balderston said he agreed with what had been said by others at this meeting. He felt the policy of the previous period should be continued for the next three weeks, but he hoped that events might permit pressing the bill rate somewhat closer to the discount rate.

Chairman Martin said he continued of the view that both the domestic business situation and the balance of payments situation had been improved by the actions of the System this summer, which had tended to take up some of the slack in the line. Reports of an overabundance of mortgage money in some areas, as mentioned by Mr. Irons, gave pause for concern.

The Chairman went on to say he had always been of the feeling that, generally speaking, it was inadvisable to provide for a change of policy within the course of a three-week period between Committee meetings. Policy should be made at meetings of the Committee and not be projected into a future time period. It seemed to him that in the present situation it would be well to wait until the October 1

meeting, when the Treasury would have completed a major financing operation, to decide on any change in policy that might seem to be neeeded.

Chairman Martin suggested that the policy directive might be changed to make reference to the Treasury refunding operation because of its size, although such recognition might not be necessary on all occasions of Treasury financing. This could be done, if the Committee so desired, simply by inserting the words "and taking account of the current Treasury refunding operation" in the first part of the second paragraph. He proposed that a vote be taken on the directive in a form in which it would otherwise be unchanged, with the understanding that this would infer the maintenance of policy "as is" for the forthcoming three-week period.

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

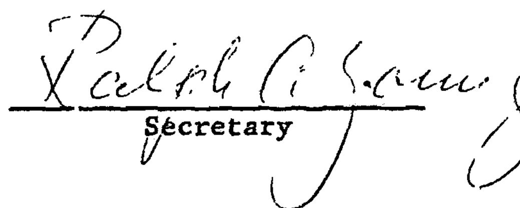
It is the Committee's current policy to accommodate moderate growth in bank credit, while putting increased emphasis on money market conditions that would contribute to an improvement in the capital account of the U.S. balance of payments. This policy takes into consideration the continuing adverse balance of payments position and its cumulative effects and the high level of domestic business activity, 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, and taking account of the current Treasury refunding operation, System open market operations shall be conducted with a view to maintaining the prevailing degree of firmness in the money market, while accommodating moderate expansion in aggregate bank reserves.

Votes for this action: Messrs. Martin, Hayes, Balderston, Clay, Irons, King, Mitchell, Robertson, Scanlon, Shepardson, and Wayne. Votes against this action: none.

It was agreed that the next meeting of the Open Market Committee would be held on Tuesday, October 1, 1963.

The meeting then adjourned.



Secretary