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, October 1, 1963, at 9:30 a.m.

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

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

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

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

Mr. Cardon, Legislative Counsel, Board of Governors
Mr. Broida, Assistant Secretary, 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
Miss Eaton, Secretary, Office of the Secretary, Board of Governors

Mr. Heflin, First Vice President of the Federal Reserve Bank of Richmond
Messrs. Holmes, Mann, Ratchford, Rawlings, Jones, and Grove, Vice Presidents of the Federal Reserve Banks of New York, Cleveland, Richmond, Atlanta, St. Louis, and San Francisco, respectively
Mr. Litterer, Assistant Vice President, Federal Reserve Bank of Minneapolis
Mr. Eisenmenger, Director of Research, Federal Reserve Bank of Boston
Mr. Cooper, 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 August 20, 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 September 10 through September 25, 1963, together with a supplementary report covering the period September 26 through September 30, 1963. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Coombs commented that the U. S. gold stock remained unchanged this week for the seventh successive week. He was hopeful that the Treasury would be able to get by for another month without showing further losses. From time to time there had been a certain amount of speculative buying of gold in the London market, but this influence had been overshadowed by heavy Russian sales

to finance wheat purchases in addition to the usual seasonal needs. At the beginning of September the gold pool reserve was reduced to a low level, but since then it had been rebuilt and some gold had been disbursed to members of the pool.

Mr. Coombs observed that the preliminary U. S. balance of payments figures suggested improvement in the month of September from the heavy August deficit. While one would not be able to tell with certainty until the figures for the third quarter were available in more detail, he had the impression from various sources that there might be a major improvement occurring in the capital market, with a virtual freeze on new foreign long-term issues, and possibly a substantial decline in short-term outflows. This could conceivably be offset by delay on the part of corporations in repatriating profits, due to some concern about the possibility that additional measures might be taken that would impair their ability to invest funds abroad.

A hopeful sign in the short-term capital area was the fact that New York City banks seemed to be moving into a stronger competitive position vis-a-vis the Euro-dollar market and Canadian banks. A three-month rate of 3-5/8 per cent was now fairly common in New York City, with a number of quotations at 3-3/4 per cent recently, as compared with Euro-dollar rates of 4-1/16 to 4-1/8 per cent and a Canadian rate of 3-7/8 per cent. Even a slight stiffening of rates here, combined with a

slight easing of European and Canadian rates, could bring about a substantive return flow of deposits.

The foreign exchange markets had been beset by severe pressures, mainly focusing on the Canadian dollar, the Dutch guilder, the German mark, the Swiss franc, and the Italian lira. A deficit in the Italian payments balance was appearing again, and there were indications that the Bank of Italy might be about to put pressure on Italian commercial banks borrowing in the Euro-dollar market. This would be helpful in bringing down Euro-dollar rates. If the Bank of Italy were unsuccessful in its endeavor, it would be faced with a choice of accepting heavy reserve losses or seeking credit assistance by drawing against the Federal Reserve swap facility or going to the International Monetary Fund. In an effort to relieve somewhat this prospective pressure on the Italian payments position, Mr. Coombs had recommended to the Treasury that the Stabilization Fund begin to acquire lire against dollars in anticipation of prepaying lira-denominated Treasury bonds. This suggestion had been accepted, and the program was under way, with about $15 million of lire having been purchased thus far. It was also important, Mr. Coombs added, to inject into the picture the concept of reversibility as far as Treasury intermediate-term foreign currency bonds were concerned.

In the case of the Swiss franc, Mr. Coombs said that more than $100 million in forward contracts had been made for the account of the

U. S. Treasury to stem the volume of capital flows into Switzerland. Speculation on the possibility of some drastic revision of the international financial system being proposed at Fund and Bank meetings had probably played a role, and credit conditions in Switzerland were a bit on the tight side. In the past few days the pressures had become even stronger, and it was impossible to deal with them through forward operations. The Swiss National Bank was compelled to take in over $50 million, putting dollar reserves above the usual ceiling of $175 million. It seemed desirable to mop up the surplus dollars by drawing on the swap facility with the Bank for International Settlements, and this had been done. If there should be an improvement in psychology, perhaps the Account could begin reverse operations.

During the past period, there had also been severe pressure in the guilder market.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period September 10 through 30, 1963, were approved, ratified, and confirmed.

Mr. Coombs recommended renewal, on a three-month basis, of the swap arrangements with the Swiss National Bank, the Bank for International Settlements, the Bank of Italy, the Austrian National Bank, and the Bank of Sweden, all of which were to mature shortly (the most recent renewals were dated July 18, 1963, in the first three cases, July 24 in

the fourth case, and July 17 in the final case). The amounts of the current swap arrangements were $50 million with the Bank of Sweden, $150 million with the Bank of Italy, $100 million with the Swiss National Bank and the Bank for International Settlements, and $50 million with the Austrian National Bank.

Mr. Swan noted that the Austrian swap was originally designed for the purpose of delaying gold losses temporarily, and he inquired as to the current situation.

Mr. Coombs replied that Austria was continuing to run a balance of payments surplus and that he saw no turn in the immediate offing. It seemed inadvisable to draw on the swap, in these circumstances, to try to mop up the surplus dollars. Probably the only answer, aside from gold sales, to further Austrian acquisitions of dollars would be the issuance of U. S. Treasury foreign currency bonds; since the Treasury had that facility available, it seemed prudent for the Federal Reserve to stay out of the picture.

Mr. Mills noted that certain European countries, such as Austria, with balance of trade deficits were balancing their international accounts through tourist trade revenues. In Italy, particularly, there had been comments recently concerning the pressure Italy was feeling at the present time because of the seasonal reduction in tourist expenditures, which was aggravating the balance of payments deficit. He inquired whether there appeared to be any inclination to reduce imports

from the United States as a means of lessening dependence on tourist expenditures.

Also, there was an outflow of dollars from this country in the form of such expenditures that could be plugged quickly if the Government saw fit.

Mr. Coombs observed that any such restrictive action might result in quick retaliation abroad. Various types of moral suasion might be used to some extent, but drastic efforts to reduce tourist expenditures could result in the use of retaliatory measures.

In further discussion of this point, it was mentioned that restrictions on tourist expenditures had been dropped by all of the major industrialized countries except Japan and that the introduction of new restrictions in that regard by countries with convertible currencies might raise questions under Article VIII of the Articles of Agreement of the International Monetary Fund. It was also noted that in the case of Austria, for example, tourist expenditures by U. S. citizens formed only a small part of the total tourist revenue.

Mr. Coombs then noted that the International Monetary Fund, at its annual meeting now in progress, would probably recommend a comprehensive study of ways and means of dealing with the problem of international liquidity. The System's reciprocal currency arrangements with foreign central banks performed an important function in providing such liquidity. If these arrangements were to come under some type of

international study, he thought it would be desirable to close any remaining gaps in the network and try to improve the alignment of the individual swap arrangements to such extent as might seem indicated in the light of potential payments swings. The Committee had discussed this on a number of occasions; and at the last meeting he had suggested the desirability of increasing the size of the German and Italian swap lines. The potential swings in the German and Italian dollar positions as the result of temporary seasonal or other reversible flows clearly appeared, in the light of actual experience, to exceed the $150 million swap lines now in force. He would, therefore, like to request authorization to negotiate with the German Federal Bank and the Bank of Italy to increase the swap agreement to a level of $250 million in each case.

Mr. Mills inquired as to the reason for an undertaking of that sort with Italy when the payments swing was moving against that country, and Mr. Coombs suggested that it was necessary, in these matters, to think in terms of a two-way street. When a foreign partner got into difficulty, it was just as important to do what was possible through the swap arrangements to support its position as for that country to support the U. S. position when this country was in difficulty. If the Italians ran into balance of payments problems, as in recent months, it would be more advantageous for the United States and for the world payments system if these swings could be taken care

of through the use of such arrangements than if alternative measures were used that would have an adverse impact on the U. S. balance of payments deficit.

Mr. Mills inquired whether, in the case of Italy, the proposal was aimed at providing background support for the lira; whether, even though there was not an urgent need for this country to help, Mr. Coombs would anticipate their drawing on the swap arrangement even in advance of repayment of the longer term debts this country had already incurred in Italy.

Mr. Coombs indicated that he was hopeful that the Treasury would move to prepay outstanding lira-denominated bonds, but he doubted that this would suffice to take care of the possible deficit in the Italian balance of payments. In the present situation, it seemed likely that the Italians would draw on the swap. On the other hand, the System had drawn on the swap too, and the Treasury had done a great deal of financing in Italy. Over the next few months, the System might have to draw on the enlarged German swap; and the Italians might have to draw on their swap arrangement.

Mr. Mills asked whether the Italians had indicated that they hoped for an increase in the swap, and Mr. Coombs said the Italians had indicated that they felt a bit short in terms of international credit. They were seeking an increase in their quota from the Fund, but in the short run they might well have a need for immediate credit. The most effective way of supplying that credit would be under the swap.

Mr. Mitchell inquired whether the Bank of Italy should not initiate negotiations if it felt the current swap line was inadequate, and Mr. Coombs replied that in due course he thought such a general procedure would be appropriate. In actual fact, however, the System had taken the lead throughout in the swap arrangements; it was being looked to for leadership and guidance. There were competing ideas as to just where the whole development of the international financial system might be going, with some individuals supporting ideas that were not at all sympathetic to the U. S. He continued to feel that for quite a while the System might have to retain the initiative.

Chairman Martin expressed the view that while the problem had not been solved entirely, considerable progress had been made in developing an understanding of what was involved.

Mr. Hayes emphasized the helpful attitude of the Italians during the past couple of years at times when the U. S. needed help. He agreed with Mr. Coombs that this country was being looked to for leadership in the new fabric that was being built. Other countries seemed to like the idea of increasing the swap lines; this was a fully cooperative move and not something the System was trying to press, but the System was being looked to for guidance.

Mr. Robertson asked whether the enlarged swap line had already been discussed with the Italians, and Mr. Coombs said that System representatives had been raising general questions over a period of months as to what extent swap lines should be tied into swings in payments

positions. This had been done in the case of the Bank of Italy. There had been nothing very specific in these discussions, but the possibility of increasing the swap facility had been mentioned. System representatives had taken the line generally that this was a fluid, experimental thing, and that there was a real possibility in certain instances that larger credit facilities might be useful.

Mr. Ellis suggested that as long as the U. S. remained in a deficit position, the swap arrangement was looked upon as another stop-gap device to help the U. S. with its balance of payments problem. Each time the swap lines were increased piecemeal, this added to the impression. He asked whether it seemed that with the two proposed increases, the swap network might remain in status quo for some period of time.

Mr. Coombs replied that with these two increases, and with two other proposals that he would mention later, he felt that the swap network would be pretty well rounded out.

Mr. Mills stated at this point that he would feel obliged to dissent from the Italian proposal as being premature. It was important, he thought, that the record disclose this discussion because this appeared to be a turning point. The range of procedures that was proposed to be followed varied from some of the considerations that had drawn the Committee initially into the program of foreign currency operations.

Mr. Hayes then commented that it seemed to him that from the outset the Committee had recognized that, although the pressures then being dealt with were nearly all against the dollar, the swap arrangements were two-way facilities.

Chairman Martin expressed the view that it would be unfortunate at this juncture to say that this was the point where the swap program was going to be cut off. It seemed to him that these experimental operations had been useful and effective.

Mr. Mills commented, however, that in the Italian matter the System was offering a plan that had not been proposed to it, and with no fundamental reason that he could see for undertaking it at this point. He also suggested that Committee representatives should be cautious about engaging in conversations leading to commitments on behalf of the Committee.

Mr. Coombs replied that there had been no commitment. It seemed to him that it was essential, in such a matter, for the Committee to have knowledge as to how a foreign central bank would react; whether it would look with favor or disfavor upon a particular operation. This sort of thing was discussed in general terms on a regular basis. Otherwise, he would not be able to inform the Committee as to how the whole picture was shaping up in the eyes of the foreign central banks.

Chairman Martin commented that he felt there had been an evolution of thinking even within the Committee, which had been somewhat skeptical in its original approach. In his opinion, considerable progress

had been made. But negotiations, to be successful, had to be conducted over a period of time and in a framework of continuous discussions.

Mr. Mitchell again raised the question whether it would not be appropriate in principle to let the Bank of Italy bring up the matter of an increase in the swap line. He recalled that the Committee had discussed on several occasions possible guidelines for the size of swap agreements. A staff memorandum had been prepared at one point that, as he recalled, indicated that it was not practicable to lay down hard and fast guidelines, so the Committee had been moving more or less as the need dictated. He did not feel that there was anything to dictate a need for an increase in the swap agreement with the Bank of Italy as far as the System was concerned.

Mr. Coombs expressed doubt that it was possible to calculate too far in advance. A year ago, for example, it would have been difficult to foresee developments that led now to suggest increasing certain swap lines.

Mr. Robertson inquired about the possibility of acting on a basis whereby the Committee would agree to approve an increase in the swap agreement if the Bank of Italy so requested, and Mr. Coombs suggested that if the System approached the German Federal Bank and negotiated a swap increase, the Bank of Italy might wonder why it had not been approached in similar fashion. If the System waited to be approached, that might create some misunderstanding.

Mr. Hickman referred to the beneficial effects, in terms of the U. S. balance of payments, from a drawing by the Bank of Italy under the swap facility as opposed to possible alternative procedures, following which Mr. Balderston said that when the Committee initiated the foreign currency program, he was somewhat concerned about how these arrangements might end up. Although his concern had been dissipated, it seemed to him that one criticism that had been leveled should be dissipated, namely, that the United States had arranged these operations in order to avoid meeting the basic issue of re-establishing equilibrium in its balance of payments. Unless the System continued to take the initiative in arranging these swaps with foreign central banks, the critics would be confirmed in their opinion that the System's only interest was in meeting U. S. difficulties rather than in working with the industrialized nations toward the development of a formula that would meet speculative runs on a currency. If the Committee were to approve the German swap increase, but not approve the Italian, that would confirm the views of the critics that the U. S. was looking out for itself only.

Mr. Hayes said he thought it was worth stressing that, while the Italian balance of payments picture looked rather weak now, such things have a way of changing fast. It had been only about a year since the Italian picture looked very strong, and the U. S. Treasury was concerned about how to meet the pressure on the dollar. This was

a country of considerable importance, with payments swings large enough in both directions to warrant a swap agreement of $250 million.

Mr. Mitchell then indicated that although he would prefer to have the Bank of Italy approach the Federal Reserve, he would not pursue the point further. He would withdraw his objections on that basis.

Mr. Mills stated that he would wish to be recorded as dissenting. He thought it was important that there be a clear indication in the record that the subject had had exhaustive discussion, and was anything but a closed matter.

> Thereupon, upon motion duly made and seconded, the renewal for three months each of five reciprocal currency agreements that were to mature shortly, as recommended by Mr. Coombs, was authorized; and Mr. Coombs was authorized to negotiate increases from $150 million to $250 million each in the reciprocal currency agreements with the German Federal Bank and Bank of Italy. The actions taken were by unanimous vote except that Mr. Mills dissented from authorizing the negotiation of an increase in the swap agreement with the Bank of Italy.

Mr. Coombs said there was ample evidence that the present swap arrangement with the Netherlands Bank, for $50 million, was on the low side. There had been drawings on three occasions, each time in the full amount of the swap, and flows into the Netherlands had from time

to time been heavy. In the most recent instance, rumors of a revaluation of the guilder contributed to a large flow of dollars into Amsterdam. The System drew under the swap arrangement and disbursed the full amount, but the dollar holdings of the Netherlands Bank were still above the ceiling. The issue was clear: the arrangement of additional financing under the swap or purchases of gold by the Netherlands. The Netherlands Bank would be agreeable to an increase in the swap facility to $100 million, and he would so recommend, with the understanding that probably the additional guilders would immediately be drawn and disbursed to bring the dollar holdings of the Netherlands Bank back down to around $200 million.

In discussion, Mr. Coombs said that the original skepticism of Netherlands authorities with regard to the swap agreement procedure appeared to have diminished as the result of the record that had been compiled of liquidating drawings promptly; there was recognition of the fact that the Federal Reserve had adhered to its promises with regard to the nature and objectives of the swap program. As to the consequences of the speculation engendered by rumors of devaluation of the guilder, Mr. Coombs pointed out that Amsterdam is a relatively small money market; he felt that the flow of funds into the Netherlands might rather promptly be reversed.

Thereupon, upon motion duly made and seconded, and by unanimous vote,

> the Special Manager was authorized to negotiate an increase from $50 million to $100 million in the swap facility with the Netherlands Bank.

Mr. Coombs then brought up the question of entering into a swap arrangement with the Bank of Japan. He pointed out that Japan is a major industrial nation, a sizable factor in international trade, and experiences important swings in its payments balance. The deterrent to entering into negotiations with the Bank of Japan had been its lack of status under Article VIII of the International Monetary Fund; the yen had not yet qualified as a fully convertible currency. However, it was anticipated that the Japanese Minister of Finance, during the Fund and Bank meetings, would probably announce Japan's firm intention of moving to Article VIII status next year. There was also a strong likelihood that Japan would be brought into the Organization for Economic Cooperation and Development group within the next month or so. In a sense, once these moves were accomplished, Japan would be even better qualified for inclusion in the swap network than some of the smaller European countries. In view of what might now be regarded more or less as a certainty, that is, the obtaining of Article VIII status, Mr. Coombs could see considerable advantage in anticipating the step by bringing Japan into participation in the swap network, and in so doing rounding out the network, possibly in more or less final form, especially as to geographical coverage. If the Committee should

want to adhere strictly to Article VIII status as a prerequisite for participation in the swap network, there might be a compromise arrangement under which a standby swap agreement with the Bank of Japan would be negotiated and announced, subject to the understanding that neither the Federal Reserve nor the Bank of Japan would draw against the swap until the Japanese move to Article VIII status had been formally completed.

In discussion of the matter, Mr. Mills said that he would raise even more strongly in the Japanese case the objections he had expressed with regard to the Italian proposal. He felt that an approach to the Bank of Japan would be premature in the extreme. The Committee had received from the staff, under dates of September 27 and 30, 1963, an extensive survey of the Japanese economic and financial position which showed that the Japanese external short-term debt was far in excess of gold and foreign exchange reserves. Also, there had been a sharp rise in imports and a rapid growth in the deficit on trade account. If the swap arrangement were approved at the present time, this would be one less reason for the Japanese to subscribe to sound international financial principles according to Monetary Fund discipline, because they would have another line of credit at their disposal.

Mr. Coombs said that if Japan were in a basic deficit position, he would assume it would be made quite clear to Japan that it

should go to the Monetary Fund rather than draw under a swap arrangement. Adherence to the basic rules of the game was expected on the part of all partners to the swap agreements; all of the swap arrangements were subject to the explicit understanding that no drawings would be made except by mutual agreement.

Mr. Balderston asked Mr. Coombs whether it might not be well if the Open Market Committee were to withhold any negotiation or announcement of a standby arrangement with Japan until Japan's Article VIII status was definite. If this were done conditionally, it might encourage approaches from other countries for inclusion in the swap network.

Mr. Coombs replied that he thought the Committee might prefer to move fast and give the impression that the swap network had been completed. He felt that it would be a mistake to allow the swap program to extend beyond the major industrialized countries, and sooner or later this would have to be made clear on the record. As long as a place was held open for Japan in the swap network, there seemed more risk of vulnerability to other approaches.

Mr. Mitchell commented that the swap relationships with the Europeans were regarded by Latin American countries as an evidence of solidarity and mutual concern that the United States did not share so far as they (the Latin American countries) were concerned. It seemed to him that a rounding out of the swap network by bringing Japan into

it would only give added impetus to the feeling that the United States was not too much interested in the countries to the south. From the standpoint of the future, he felt that this country should be showing a great deal more interest in that area. The Committee, he noted, had not considered carefully the proposition that a swap arrangement with Japan would constitute the end of expansion of the swap network for some time to come. Thus far the Committee had proceeded on a case-by-case basis, as the need dictated. Accordingly, he was rather surprised by the comment that a Japanese agreement would close the swap network for some time to come; this would represent a major decision that should receive considerable attention on the part of the Committee.

Chairman Martin noted that the problem here was a little different from the German and Italian matters, previously discussed, because the Japanese were anxious to come into the swap system. The currency, however, was not yet fully convertible, which raised a question as to how to handle the matter.

Mr. Mitchell said that he would feel more comfortable if he had more time, and the benefit of the thinking of others, on the proposition of confining swap arrangements essentially to countries within the OECD group. He would not feel prepared to take a position on that issue today.

Chairman Martin then asked Mr. Coombs whether it would serve his purpose if the Committee authorized him to talk to the Japanese and bring back to the Committee for consideration any proposal that might be suggested.

Mr. Hayes commented that there were pressures from many directions for building greater international liquidity, and some of these pressures were from persons who would build it in a much less effective way than through the methods being used by the System and the Treasury. He felt that an effective structure of bilateral arrangements, with the inclusion of Japan, would act as a deterrent to the less sound suggestions that were circulating in a number of high places around the world.

Question was raised whether an understanding, in connection with a swap arrangement with the Bank of Japan, that the facility would not be utilized until Japan achieved Article VIII status would be likely to speed up that process, and Mr Coombs pointed out that certain regular procedures would have to be followed before Article VIII status could be obtained. He doubted that the necessary actions could be taken before next February or thereabouts. Asked whether the Japanese might not be particularly anxious to obtain a swap line of credit as a support against speculative pressures attendant upon the achievement of Article VIII status, Mr. Coombs said he would not expect the yen, if fully convertible, to be subject to any greater

speculative pressures than had existed thus far. However, there were certain trade relationships between Japan and the Western countries that would have to be worked out. In further discussion, Mr. Young recounted the extent of steps taken to date, and remaining to be taken, by Japan in the removal of restrictions on current account payments. Question also was raised as to the possible magnitude of any swap arrangement with the Bank of Japan, and Mr. Coombs said that he was not sure. As an offhand guess, he would say something in the order of $150 million.

Chairman Martin then suggested again that Mr. Coombs be authorized to discuss the matter of a possible swap arrangement with the Bank of Japan, with the understanding that the matter would then be brought back to the Committee for further consideration. In the meantime the staff could prepare a memorandum on the whole problem of the scope of the swap network for consideration by the Committee.

There was general agreement with this suggestion.

Mr. Coombs said that his last recommendation related to forward operations. In an appendix to the Special Manager's report to the Committee on operations during the period September 10-25, 1963, there appeared a summary of operations for Treasury account in forward Canadian dollars. Briefly, incident to the Russian wheat deal in process, there was in prospect a heavy transfer of U. S. dollars to Canada. This had resulted in a heavy demand for forward Canadian

dollars, which in turn added considerably to the interest arbitrage in favor of Canada. If this process had been allowed to run its course, conceivably it could have resulted in a heavy flow of short-term funds to Canada. Through operations of the Bank of Canada and of the New York Reserve Bank (acting for the Treasury) to sell Canadian dollars forward while buying Canadian dollars spot, the premium on the forward Canadian dollar disappeared. This squeezed out the arbitrage in favor of Canada and nipped what might have been a sizable flow of funds. The operation had been a useful one, and the Canadians were pleased with it. He could visualize that from time to time in the future similar operations might be of considerable help in checking, before they got under way, arbitrage flows of even greater magnitude than what had been the potential flow to Canada. If there was an authority for operating in the forward market on such occasions--selling forward and simultaneously buying a currency spot--some outflows of short-term capital could be checked. He would like, therefore, to request authority, up to a total of $50 million, for buying foreign currencies spot and selling them forward for the specific purpose of restraining short-term capital outflows induced by arbitrage considerations. This would be in addition to the two outstanding authorizations for forward operations, each in the amount of $50 million, that related to covering commitments under swap drawings.

In discussion, a suggestion was made that it might be preferable to raise the over-all authority for forward transactions to $150 million, such figure to cover all three types of such operations, and Mr. Coombs replied that he would welcome the additional flexibility.

Accordingly, 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 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 operate in any or all of the foregoing currencies, in accordance with the Guidelines and up to a combined total of $150 million equivalent, by means of:

(a) purchases through forward transactions, for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements;

(b) purchases and sales through forward as well as spot transactions, for the purpose of

utilizing its holdings of one currency for the settlement of commitments denominated in other currencies; and

(c) purchases through spot transactions and sales through forward transactions, for the purpose of restraining short-term outflows of funds induced by arbitrage considerations.

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 September 10 through September 25, 1963, and a supplementary report covering the period September 26 through September 30, 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 and securities markets have weathered the past three weeks of advance refunding and tax and dividend payments quite smoothly. Net reserve availability was permitted to respond flexibly to market needs, rising when those needs were at their peak and then moving lower as the needs receded. In this way it was possible to maintain a generally steady day-to-day tone in the money market. The great bulk of Federal funds trading was at 3-1/2 per cent, while member bank borrowing fluctuated quite sharply from day to day but, on average, was in the recent range variation for the period as a whole. Once again, events during the period were a reminder that summary reserve statistics are an imperfect guide to the condition of the money market--particularly when distribution within the total may swing so sharply from day to day and when even the aggregates themselves are subject to substantial later revision.

System operations withdrew reserves to offset market forces in the first half of the recent period. These withdrawals were undertaken cautiously, however, in view of the

great volume of churning in financial markets around the tax date and in connection with the advance refunding. Starting September 19, the System turned around and began supplying reserves as market factors absorbed them.

The advance refunding, of course, has been the center of attention in the long-term bond market during the past several weeks. As described in the written reports, the advance refunding of some $6-1/2 billion out of $23 billion of public holdings of rights was considered a highly satisfactory result--both by the Treasury and in the market. Public takings of $3.7 billion of the new 4's of 1973 and $1.3 billion of the reopened 4-1/8's of 1989-94 were especially gratifying in view of the recent comments made by some market observers to the effect that current long-term rates were out of touch with the "real" state of demand and supply because of official purchases of intermediate and longer issues.

The dealers took substantial positions in the refunding issues, and thus far have been willing to reduce those positions only at rising prices--and even then they have shown no aggressiveness in letting bonds go. The atmosphere surrounding this distribution process, and the bond market in general, remains good. Prices of most longer term issues are above their levels of three weeks ago notwithstanding the larger-than-expected additions to supplies produced by the exchange.

In the meantime a better atmosphere has also emerged in other long-term markets. Last week, a high grade industrial bond offering in the amount of $100 million sold out quickly at a yield well within the range of recent reoffering yields. In the tax-exempt area, distribution of the slower-moving recent offerings has picked up after prices were reduced and the latest offerings have moved quite well. Further tests await the tax-exempt market, however, with a large calendar of offerings to be assimilated in the weeks ahead.

Turning to Treasury bills, there was some concern expressed at the last meeting of the Committee to the effect that demand for bills growing out of the advance refunding might tend to pull rates substantially lower. As it turned out, the demand for bills from sellers of rights tapered off in the latter part of the period that subscription books were open, and offsetting upward pressures on bill rates soon emerged as the mid-month tax date approached. Investment demand reappeared after the tax date but market supplies,

augmented by the Treasury's second monthly offering of one-year bills, have been adequate and no serious erosion of rates has developed. In yesterday's auction the 3- and 6-month rates were set at about 3.41 and 3.52 per cent--roughly 5 basis points higher than they were three weeks ago, but within the range in which they have recently moved.

Treasury financing operations in the next few weeks are expected to center in the bill market. Payment is being made today for the second billion dollar offering of month-end one-year bills, which raises about $0.5 billion new cash after paying down a $0.5 billion issue of maturing 1-1/2 per cent notes. On October 15 there is a $2.5 billion maturity of the old quarterly series of one-year bills, and it is expected that the Treasury will meet most of this outpayment through the sale of $2 billion of March tax anticipation bills. Later in the month they may sell a $1 billion strip of bills to recoup the balance of the cash drain on October 15 and to raise some additional cash. And of course they plan to sell, around the end of the month, the third in the monthly series of $1 billion one-year bills. Finally, the Treasury plans to announce the terms of its November refunding on October 23 or 24.

Our projections, and particularly those of the Board's staff, point to a substantial bulge in reserves during the last two weeks of the period ahead. The offsetting of that bulge could push us close to, and possibly through, the $1 billion limit on net changes in the Account. To be on the safe side, I should like to recommend that the limit be raised from $1 billion to $1.5 billion for the next three weeks.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period September 10 through September 30, 1963, were approved, ratified, and confirmed.

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

Other participants included Messrs. Noyes and Koch. Copies of the text of the presentation and of the accompanying charts have been placed in the files of the Committee.

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

> On occasion, economic news of little significance in itself because it is attributable to special circumstances calls our attention to important questions that might otherwise escape our notice. The decline in industrial production from July to August was news of this sort. It reflected chiefly a cut-back in steel output as a sequel to the earlier build-up of stocks. To a lesser extent it reflected a moderate further decline in auto output from an exceptional high in June. Other industrial activities taken together showed only a little further increase, but this should not be considered exceptional for a single month in a period of generally rapid advance. Thus the August drop in the index may be explained away. The decline, nevertheless, brings into the foreground of discussion questions concerning more fundamental changes in the course and composition of production--questions already implicit in the rapidity and unevenness of the advance from January to July.
>
> First, we will review the general course of events since the cyclical low in February 1961. An initial rapid advance in 1961, and then a more moderate rise, brought output to a level in July 1962 that was 9 per cent above the prerecession level of the spring of 1960. Production held unchanged at this level for 7 months, through January this year. As late as March, evidence of the direction of the next move did not seem conclusive to most observers. This was partly because the previous period of recovery and expansion, from the low in April 1958, had lasted only a little over two years and on this precedent a decline might be due. Actually, output had started to rise in February and by July it was 6 per cent higher than in January.
>
> The expansion of 1954-57 lasted a little over three years, an unusually long period in the annals of cycles. Is the present period perhaps of that sort? Similarities can be found, but the differences are great. The advance in

production from January to July this year was sharper than any rise after the early stages of the 1954-57 expansion, disregarding the steel strike of July 1956. Also, production in July this year was appreciably higher relative to the prerecession rate than production in early 1957, the corresponding time in that upswing.

With the unemployment rate generally between 5-1/2 and 6 per cent, labor force use in the past year and a half has been between 94 and 94-1/2 per cent. This is close to the level prevailing in 1959-60 but appreciably below the 96 per cent rate from early 1955 to mid-1957. Also, the rate of use of capacity for production of major materials this year has been well below the 90-92 per cent range prevailing for several quarters in 1955 and 1956.

With resources being utilized less fully than in 1955-57, competition from abroad keener, and belief in the inevitability of creeping inflation at least suppressed by events in recent years, industrial commodity prices this time have not changed enough to have any appreciable impact on broad indexes. By early 1957--the corresponding date in the expansion of the middle 50's--industrial prices had risen 10 per cent. Wage rates also show a contrast, rising at a rate less than two-thirds as fast in the recent expansion.

In addition to these marked differences from the mid-1950's in production, resource utilization, and prices for goods and services, there are many other differences. These include a different balance of payments situation, much keener competition from abroad, less volatile behavior of interest rates, and the implications of the tax bill now before Congress. It thus seems evident that no close parallel with the past can be drawn, and that our attention should instead be focused on the nature of recent changes.

There followed sections dealing with foreign developments and the balance of payments, industrial employment and activity, business capital expenditures, prices and credit market developments. The concluding portion of the review, presented by Mr. Koch, was as follows:

We have touched on a wide range of economic developments at home and abroad. We have called particular attention to

the sharp rise in industrial production from January to July, achieved with only such price increases as have been largely offset in their effects on the broader indices by declines elsewhere. The advance in output, we have noted, was so rapid and so much greater in materials than in final products that some slowing down in the advance and some shift in the composition of the advance seem to be indicated. We have made no prediction on the course of prices, not regarding the firming in numerous markets as conclusive evidence of the beginning of a widespread advance, yet not accepting the view that there is enough slack in current and prospective resources use to make unnecessary concern for developments in this area.

Nevertheless, unemployment continues to be a serious problem. It was still at a level of 5-1/2 per cent in the third quarter. Over the past year the unemployment rate has changed little, while GNP has risen over $30 billion.

Turning more specifically to monetary policy, enough time has now elapsed since the actions taken in July to evaluate in a preliminary way their effects. On the domestic side, the major effect has been in firming money market conditions somewhat further. Customer loan rates at banks have apparently shown little change. The rise in longer term interest rates in early September was more a reflection of the Treasury advance refunding than of money market conditions. It is interesting to note that the narrowing of the spread between short- and long-term interest rates in 1963 has had more the characteristics of normal behavior of the rate structure in a period of economic expansion and reduced monetary ease, that is, the whole structure of rates has risen, with short rates rising more than long rates.

As for other basic effects of monetary actions, the evidence is by no means conclusive. The money supply declined in August but rose again in September. Thus far this year, it has increased at a 3 per cent rate. Growth in bank loans and investments slackened in August, but, like money, picked up fairly briskly in September. These recent changes in money and bank credit were probably more affected by changes in the intensity of private demands for bank funds and in the specific timing of Treasury financing operations than by changes in monetary actions.

The changes in maximum rates payable on time deposits, and action on the part of some banks in raising actual rates paid, led to a sharper increase in the volume of such

deposits outstanding during late July and August than earlier. In September, however, the rate of increase slackened, in part reflecting some deposit liquidation for tax payment purposes.

The evidence on the effect of this summer's policy changes on international capital flows is also mixed. Some offsetting actions and developments have occurred in foreign rates and forward discounts. As a result, the covered rate differentials on money market paper between New York and London, and between New York and Montreal have not changed much. Also, Euro-dollar rates have risen, although not so much as to offset fully the rise in short-term U. S. rates.

On the other hand, the bank-reported outflow of funds abroad has slowed down substantially. That outflow, which averaged $150 million a month during the second quarter, was reduced substantially in July and still further in August. But the magnitude of recent flows of funds abroad not reported by banks is still mostly unknown. Moreover, exchange market developments during September suggest a rise in short-term outflows, especially to Canada but perhaps also to some Continental European countries. These flows, however, apparently were due mainly to factors other than interest rate considerations.

The sharp reduction in bank-reported flows in July and August, together with very light offerings of new issues, has no doubt reduced the over-all U. S. payments deficit from its very high second quarter rate. But after gratifying results for July, a deterioration occurred in August. Tentative weekly figures for September are inconclusive.

In deciding on the most appropriate monetary policy for the next few weeks, attention might well focus on the fact that demands for funds picked up in September. If this pickup continues, additional upward pressure on interest rates could develop as a result of market forces. Any diminution in the savings flow would accentuate this tendency. In this case, the Committee might wish to permit the increased demands for funds to be reflected, in part at least, in higher rates of interest. This would seem a more appropriate course than further action on the supply side to inch up rates. On the other hand, as the analysis this morning suggests, the pace of economic expansion could slacken and the savings flow could continue robust, in which case interest rates might come under some downward pressure. In this case, forthcoming balance of payments developments

could be a key factor in deciding whether such downward influences on interest rates might more appropriately be offset or allowed to materialize.

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

As we meet today, two and a half months after the System's latest policy moves with respect to the discount rate and Regulation Q, it seems appropriate to review very briefly what has happened in the principal areas to which we must give our attention in formulating monetary policy.

We find that the domestic business situation has continued to improve gradually, and that despite a dip in August due largely to a few special factors, there is appreciably more optimism on the outlook for business than there was in July. The major price indices have still not broken out of the narrow range in which they have moved for some four years, though there have been enough increases for individual products to suggest a need for watchfulness. Liquidity continues ample, with no clear evidence that our series of moderate moves toward lesser ease has appreciably slowed the substantial rate of bank credit expansion that has characterized the past year or more. Banks are still avidly seeking additional loans, both here and abroad. The level of short-term market rates has risen part way toward the new discount rate but is still short of it by about 1/8 per cent, long-term rates have firmed only very slightly, and the pronounced success of the Treasury's advance refunding operation has pointed up the continuing abundance of savings in relation to the demand for long-term funds. Finally, while the balance of payments should show some improvement in the current quarter over the very sad showing of the second quarter, the deficit is nevertheless running at an unsustainably high rate, and the complications introduced by the interest equalization tax make it virtually impossible to measure the results of our own policy actions. In any case, we are not achieving the degree of improvement that the world at large, and especially the principal foreign holders of dollars, many of whom are represented here in Washington this week, might reasonably expect in the light of the Administration's ringing pronouncements of mid-July.

To cite a few recent developments in greater detail, statistics that have become available since our last meeting suggest that the August dip in business activity was largely attributable, directly or indirectly, to the automobile model changeover and the continuing steel inventory adjustment; but that there was also a slower rate of advance in other sectors, with the notable exception of retail trade, which continued to move ahead strongly. With auto production now moving up, with the steel picture brightening, and with a generally favorable prospect for consumer buying and business investment in plant and equipment, it seems likely that a pick-up in general activity may have occurred in September or will occur at the latest in October. One encouraging item is the rise in after-tax corporate profits in the second quarter to the highest level since the fourth quarter of 1950. After-tax profits plus depreciation allowances reached an all-time peak, and the ratio of this aggregate to GNP equaled the previous peak of the last quarter of 1955. Even the unemployment statistics provide some slight degree of comfort, in that the unemployment rate for married men moved down in August to 3 per cent--a full one-half of a percentage point below a year earlier, and the lowest level since 1957.

The stock market's performance, with the major averages having broken into new high ground early in September, is perhaps symptomatic of the relatively high degree of business optimism. That optimism will not be lessened by the fact that the tax reduction bill has finally emerged from the House of Representatives--even though Senate action is uncertain.

As for credit developments, neither the data on total bank credit nor those on money supply plus time deposits clearly point to a change in the rate of expansion over recent months. Many of the elements that served to depress credit growth in August seem to have been quite temporary in nature. A reversal of some of these factors, together with tax date considerations, was instrumental in bringing a speed-up in the expansion of bank credit and bank loans in the first three weeks of September. However, this period is not long enough to take account of loan run-offs after the tax date. New York bank loan officers do not report any significant change in business loan demand.

The revised August balance of payments deficit of $525 million is close to the highest monthly deficit ever

recorded. Unfortunately, we have no detailed information on the causes of this deterioration, but surprisingly it occurred in the face of a sharp drop in new long-term foreign bond issues and despite some evidence of a slackening in short-term capital outflows. Very heavy seasonal tourist outlays doubtless played an important role. In more recent weeks, substantial transfers of balances to Canada have been reported, and it is also possible that there have been some precautionary transfers of capital, or unusual retention of foreign earnings, by corporations that anticipate additional taxes or controls on capital exports. This was a danger that was clearly visible when the interest equalization tax was proposed.

Over the next three weeks, the System will be relatively free to form its policies without special consideration for the Treasury's operations. Such financing as the Treasury conducts will be more or less routine and will not be jeopardized by minor policy shifts. By the time of the next Committee meeting, however, the Treasury will be on the point of announcing the terms of the November refunding.

With the balance of payments still very serious, despite some recent evidence of improvement in the short-term capital area, and with domestic business still quite encouraging, international considerations must inevitably continue to receive heavy weight in the determination of monetary policy. I think we should try to maintain the momentum of whatever benefits our discount rate action has brought with respect to capital flows. Also, the Committee members have often discussed, over the past year or so, the desirability of some slowing in the rate of growth of bank reserves and bank deposits--yet to date, as I have already mentioned, that slowing has been almost imperceptible. I believe we should seek a slightly less degree of credit availability, both to support a somewhat firmer short-term rate structure and to cause a little greater reluctance on the part of banks to lend freely abroad.

In the next few months additional reserves must be provided in any case to meet seasonal needs; but I would urge that we exercise some caution in providing them, rather than anticipating these needs. I would hope that the Federal funds rate would stay consistently at 3-1/2 per cent, that the 90-day bill rate would move up close to 3-1/2 per cent and perhaps fluctuate moderately around that figure. Borrowings might well be allowed to average around $400 million, with free reserves probably moving around the zero

level, although I would regard the level of free reserves as a secondary consideration. The directive should, I think, be modified to reflect this moderate additional move toward lesser ease.

For the time being, I believe our attention should be focussed on making the 3-1/2 per cent discount rate fully effective rather than on any additional overt step. However, it seems quite possible that some further discount rate action may be needed later this fall if the balance of payments fails to respond favorably enough to the measures already taken.

Mr. Shuford reported that the improvement in Eighth District conditions that had occurred since the first of the year was continuing, though with some slackening in the pace of improvement in the past couple of months. Business loans outstanding had risen steadily since March and this, combined with the recent increase in market rates, may have had some effect on lending rates in the St. Louis area. In June, 57 per cent of the larger loans were made at the so-called prime rate of 4-1/2 per cent, but in September only 44 per cent.

At the national level, it appeared that the economic expansion that began more than two and one-half years ago was still under way. Although the economy had come a long way since early 1961, there did not appear to be any apparent significant upward pressure on prices. The record of price stability during the current expansion had been impressive. Wholesale prices were about unchanged on balance since 1961; consumer prices had risen at an annual rate of approximately 1-1/2 per cent, about half the annual rate of increase during the three previous periods of economic expansion. Since July, member bank reserves and the money supply had shown little change. However, it

seemed more reasonable to consider monetary developments over somewhat longer periods, and on such basis rather significant increases in bank reserves and the money supply could be observed.

With respect to policy, Mr. Shuford saw no strong reason to propose any significant change at this time. In view of the balance of payments situation, he would not want to see any reduction of short-term rates. At the same time, he felt that monetary policy should continue to facilitate economic growth domestically. For the next three weeks, he would aim at maintaining short-term rates at about present levels, and he would hope that member bank reserves and the money supply would continue to rise at moderate rates. He would not recommend a change in the discount rate at this time nor would he suggest any change in the directive, except for deletion of the reference to the Treasury refunding.

Mr. Bryan reported that Sixth District statistics for August showed little change. The District figures differed from the national figures in that such declines as appeared were less than nationally, while increases--chiefly on the financial side--were greater.

Mr. Bryan said he would favor essentially no change in policy. However, reserve availability had somewhat outrun his ideas of what should have happened under current policy. He would prefer that free reserves fluctuate around the zero level.

Mr. Bopp said that although Third District indicators had shown some improvement recently, the performance was not strong enough to overcome the disappointing behavior of the economy so far this year.

As far as policy was concerned, Mr. Bopp expressed the view that things seemed to be proceeding reasonably well. Credit demand was continuing moderately strong and the balance of payments seemed to have improved somewhat. Looking ahead, he would be inclined to do nothing to alter present policy, with emphasis maintained on the tone and feel of the market rather than the level of free reserves. He would make no change in the directive except to delete the reference to the Treasury refunding.

Mr. Hickman commented that while the level of economic activity had shown little net change in recent weeks, the tenor of recent news suggested recovery from the more-than-seasonal late summer dip. So far as he could determine, production had probably increased in September. Steel output, as expected, had begun to show some expansion; auto output had increased moderately, on a seasonally adjusted basis, and was expected to increase substantially in October. The retail sales picture for September was not yet clear. Auto sales were off sharply in the first 20 days of the month because of the unavailability of new models. Department store sales were fairly strong compared with a year ago, but looked weak when contrasted with August's record level.

Although the industrial component of the wholesale price index still showed no significant change, recent announcements of price changes had, on the whole, been on the upside. Increases had become more widespread in certain industries, such as steel, non-ferrous metals, paper, and household appliances, and were appearing in selected lines of machine tools. In this connection, the Board's estimates of utilization of manufacturing capacity would bear watching. The utilization figure had increased from 77 per cent of capacity in the first quarter of 1961 to 87 per cent in the third quarter of this year, and thus was nearing the 90 per cent level at which price pressures had appeared in the past.

Economic changes in the Fourth District had been mixed, Mr. Hickman said, but with a clearly favorable development emerging in the area of insured unemployment. Insured unemployment rates in the 14 major labor market areas of the District, after seasonal adjustment, showed 10 centers with declines in unemployment between mid-August and mid-September, three with increases, and one with no change. The increases in unemployment rates occurred in steel centers.

Monetary policy in the weeks immediately ahead should, in Mr. Hickman's opinion, continue along the path of recent weeks, but with the bill rate encouraged to remain in the 3.40-3.50 per cent range. Because of the higher covered yields that had recently developed on Canadian bills, and the scattered evidence of outflows of short-term

funds to that country, he would favor a bill rate in the upper end of the aforementioned range, coupled, if needed, with further sales of Canadian dollars forward against purchases of spot Canadian dollars, within the new authorization of $150 million.

So far as the Federal Reserve System could be effective in the international sphere generally, Mr. Hickman suggested that the Committee exercise its influence to persuade countries whose currencies were strong vis-a-vis the dollar to relax their local credit conditions. He referred specifically to Canada, the Netherlands, Germany, and Switzerland, whose currencies had been very strong recently against the dollar.

Mr. Hickman said that, as he had suggested in the past, he would urge the Committee to instruct the Desk to allow bond yields to drift upward in response to natural market forces. With a period of large seasonal demands now approaching, reserve needs could best be met by reducing reserve requirements rather than through open market operations. He would recommend no substantive change in the directive.

Mr. Mitchell commented that the outlook for consumer performance seemed quite uncertain. The seasonals probably gave a false impression in August, and it was his impression that September did not look very good. Also, it seemed to him, from looking at the components, that the rise in the production index might be over for

a while. Although he was not bearish about the business outlook, he was not particularly encouraged by the most recent developments.

On the proposition of letting the bill rate get up to the discount rate, Mr. Mitchell felt that if the bill rate was allowed to fluctuate around the discount rate, the System would be under considerable pressure to raise the discount rate again. As to policy for the period immediately ahead, he would go along with those who suggested that there be no change in posture at this time.

Mr. Shepardson said that he had participated yesterday in a meeting of institutional lenders to agriculture, and was interested to find that the concern about undue extensions of agricultural credit had increased, if anything, since the group's meeting in May. Insurance company mortgage loans, both in volume and number, were up by percentages ranging from 10 per cent to as much as 35 per cent. The Farm Credit Administration was having a somewhat similar experience. All participants reported pressure to place the overabundance of available funds; and all of them pointed to the "other fellow" in terms of laxity in lending standards. One paper discussed by a representative of the life insurance companies charged an undue increase in the money supply, taking into account time deposits. Rather grave concern also was expressed about developments in housing loans, along with concern about the farm loan situation and the continuing increase in farm land prices.

Mr. Shepardson said that in light of the total situation he would be inclined to follow the recommendations on policy that had been made by Mr. Hayes.

Mr. Robertson said it seemed to him the kind of economic and financial reports to which the Committee had been listening today argued strongly against any tightening of monetary policy at this juncture. He would, therefore, recommend no change in policy, preferring to "wait and see." Mr. Robertson then submitted the following statement for inclusion in the record in further exposition of his views:

> It seems to me that the kind of economic and financial reports we have been hearing argue strongly for making monetary policy no tighter than it is at this juncture.
>
> To begin with, it seems obvious that the rate of business advance has slowed slightly in recent weeks. The chances for any strong fall upsurge in activity have been correspondingly reduced. From this point of view, what we need is a policy which helps to undergird business confidence rather than restrain it.
>
> On the financial side we have seen a run-up in bank loans, investments, and the money supply, but these seem largely related to the tax date and the Treasury refunding operation, and to that extent they have a temporary character that does not call for any policy attention. On the contrary, within these fluctuating totals the banking system seems to have been moving into a significantly less liquid position, with more borrowing from the Federal Reserve, reduced holdings of short-term Governments, and substantial lengthening of portfolios through bank participation in the advance refunding. To this extent, banks have less room to accommodate any fall loan expansion that ensues, and I think we must watch very carefully for any signs of undesirable restraints developing from this posture.
>
> Long-term capital markets also do not seem to me to be invulnerable to any further tightening of reserve availability. A growing number of municipal market experts are

warning of the blow that could strike that market from any significant reduction in the rate of commercial bank acquisitions, such as might stem from even a modest degree of reserve restraint. In the Government securities market there is a relatively large total of dealer investment in long-term issues as a result of their participation in the recent refunding. This could easily produce some sharp upward pressure on rates if dealers became restive over such exposure or found financing sufficiently difficult to make them want to reduce positions.

Developments on the balance of payments front in recent weeks, both good and bad, do not seem to me to be the sort that call for monetary policy adjustments. Indeed, staff appraisals of the reported statistics since our raising of the discount rate and tightening of reserve policy in the end of July do not seem to have been able to pinpoint any concrete and significant benefits realized from our higher money market rates. I, for one, have no stomach for swallowing any more doses of the kind of medicine that has been of such little proven help in dealing with what really ails our balance of payments. The machinations that have been going on in the Canadian exchange picture certainly should not lead us to take any further steps to tighten our markets. Canada is one country where official actions on the discount rate and in the financial markets have been directly designed to frustrate any possible gains from our previous interest rate increases, and the statements of their authorities should lead us to expect exactly the same type of frustration if we were to endeavor to move again.

I believe our best policy at this juncture should be to hold steady and watch very carefully the unfolding of the consequences of what we have already done. If, unhappily, business expansion should falter further, and signs develop of reduced bank liquidity impinging upon securities markets and credit availability generally, then a prompt move back toward a more easy monetary policy would be very much in order. If, on the other hand, business should belatedly strengthen and develop some of the fall acceleration of which it is still potentially capable, then some well-timed adjustment toward more restrictive monetary policy might be appropriate. If I had to choose one course or the other at this moment, I think the balance of risks is clearly in favor of easing rather than tightening. But I also believe that we have

sufficient leeway to wait a little longer in order to be sure of the direction of events before committing ourselves further. Accordingly, I would favor no change in policy, no change in the discount rate, and no change in the directive other than the dropping of the reference to the Treasury financing.

Mr. Mills presented the following statement:

It is now time to adapt Federal Reserve System monetary and credit policy to prospective financial and economic developments in the last quarter of 1963. On the strength of statistical evidence through the month of September, it is reasonable to anticipate a somewhat more than seasonal rise in economic activity over the rest of the year. However, no real improvement in the nation's balance of payments difficulties can be foreseen, and it is possible that they may be aggravated by publicized arguments aired at the meeting of the International Monetary Fund concerning conflicting theories for stabilizing the international exchanges. Such publicity could lead to speculation against the United States dollar. Although the proposed interest equalization tax seems at least to have temporarily checked the outflow of long-term funds, gains in that direction may be lost through increased outflows of short-term funds, partly stimulated by the liberalizing effects of the Board's revised Regulations M and K. The effectiveness of the Federal Reserve System's operations in foreign currencies would be lessened by such developments. If these adverse events should materialize, fiscal controls limiting foreign access to the short- and long-term U. S. capital markets should be instituted promptly; and it is hoped that preparations have been made to that end.

As has been the case in 1963 to date, monetary and credit policy must take into account both domestic and international considerations. As the main attack on the balance of payments problem has focused on admittedly temporizing Federal Reserve System operations in the field of foreign currencies, that have not been supported by appropriate fiscal controls for reaching the problem at its source, the burden of attempting a solution has been shouldered onto the Federal Reserve System and has necessitated a more restrictive monetary and credit policy than is justified by present economic conditions. Without a

change in official policy attitudes bearing on the balance of payments problem, the Federal Reserve System regrettably is committed to promoting an interest rate policy aimed at shielding the United States against the further loss of gold and dollars. But in view of inflationary developments in several continental European countries and their understandably self-serving needs, rates of interest abroad are tending to move up and to stay above those ruling in the United States. As that is the case, it is unlikely that policy actions attempting to force competitively higher interest rates in this country can be undertaken successfully without causing a contraction of credit and a reduction in the money supply that would severely retard any improvement in economic activities that otherwise could be achieved.

If the balance of payments situation should worsen, it is my belief that the Federal Reserve System should not offer resistance by strengthening the restrictiveness of its credit policy. There would then be visibly good and sufficient reasons for urging the Federal fiscal authorities to promulgate selective controls over outward capital flows from the United States which, if introduced, would serve to relieve the Federal Reserve System from adherence to its present debatable monetary and credit policy which is vaguely expressed in the current economic policy directive to the Federal Reserve Bank of New York as being, "conducted with a view to maintaining the prevailing degree of firmness in the money market, while accommodating moderate expansion in aggregate bank reserves." Under such circumstances, Federal Reserve System monetary and credit policy could proceed to concentrate on the domestic economy by exercising its full influence toward stimulating economic growth and activity. A change in policy of this kind should carry with it the opportunity for discontinuing the pegged interest rate policy now in vogue and for returning to a policy that would permit interest rates to move freely in response to supply and demand factors in the financial markets subject only to the marginal influence exerted by the System as it saw fit to supply or withdraw reserves from the commercial banking system, in keeping with the justifiable credit requirements of the business and financial communities.

Release from the shackles of an artificially coddled U. S. Government securities market and return to free market

principles in the conduct of monetary and credit policy would contemplate reverting to at least a "bills usually" policy and ceasing from actions that have attempted to raise short-term and lower long-term interest rates. In the process of resuming this previously favored monetary and credit policy, it is reasonable to expect that a normal spread between short- and long-term interest yields on U. S. Government securities would result, and as the present flat yield curve disappeared, commercial bank investors could again judge the market realistically. In that event, overconfidence in the stability of the interest rate structure would also vanish and the temptation to commercial banks to extend the maturities of their investments in order to obtain fractionally higher interest income would be removed, and along with it the risk of a depreciation in their investment holdings occurring at the inevitable time that unforeseen contingencies would result in destroying the artificial structure of the market for U. S. Government securities that now exists.

Mr. Mills said that the foregoing statement contained a great deal of wishful thinking that he felt sure would not be realized. In the circumstances, it was his position that there should be no change in policy at the moment, although he would veer more in the direction suggested by Mr. Bryan.

Mr. Heflin reported that Fifth District business had maintained a slow, sometimes uneven, upward course, much as it had over a period of many months. Consistent gains in nonfarm employment had continued to show that progress was quite widespread and seemingly possessed a fair degree of momentum. Department store sales reached a new high in August and preliminary indications were favorable for September. Construction employment had remained at record levels, although contract

awards and building permits had sagged slightly. A note of uncertainty existed in the District's agricultural sector, which had not fared as well recently as the rest of the economy. With about 45 per cent of the District's flue-cured tobacco crop sold, prices had averaged 4 per cent below last year, volume was down about 16 per cent, and gross returns were off 19 per cent. Those trends could mean a reduction in income from flue-cured tobacco sales of as much as $85 million compared with 1962. Except for agriculture, trends revealed in the latest Reserve Bank survey were again quite favorable. General business sentiment was considerably stronger than three weeks ago, and manufacturers gave moderately favorable accounts of new orders and shipments, with little or no change in employment and hours. About one-third of the manufacturers reported wage increases.

Mr. Clay said that the domestic economy appeared to be performing essentially in line with earlier expectations. Expansion at a moderate pace appeared to have characterized the third quarter. While the record of the fourth quarter was yet to be written, continued economic expansion remained a reasonable prospect. On balance, however, this meant that the domestic economy continued at an expanding level of activity that was inadequate to absorb the economy's growing resources. Accordingly, the domestic economy still needed the stimulus of an expansive monetary policy.

Obviously, the international balance of payments deficit remained a serious problem, Mr. Clay noted. At the moment, there appeared to be a need for more adequate information as to recent developments in the various components of the balance and as to the response to public policy actions taken during the last two and a half months. Some additional modification in monetary policy could be made by the Committee within the limits of the recent change in the discount rate. In view of the continuing question as to the appropriate role of monetary policy under existing circumstances, it would appear to be in order at this time to await some clarification of developments and response to policy actions already taken before proceeding further.

Considering all factors, both domestic and international Mr. Clay expressed the view that it would appear desirable to maintain essentially the same monetary policy posture that had developed since the discount rate increase in mid-July. The directive could be left unchanged except for deletion of the reference to Treasury financing.

Mr. Scanlon reported that economic activity in the Seventh District had continued to improve gradually. Steel production was rising further, the early reactions to the 1964 model autos were favorable, grain prices were well above year-ago levels in the face of large crops, and business sentiment was generally optimistic. Retail sales of soft goods in September apparently had not equaled

the August level, but it seemed premature to conclude that this was the beginning of a downward trend.

Current data on savings flows, Mr. Scanlon said, indicated that consumers might be spending somewhat more freely. While sales of savings bonds had continued above year-ago levels, redemptions had risen and in the early weeks of September had exceeded sales. The net inflow of funds to savings and loan associations in August was below the year-ago level, largely because of an increase in withdrawals, and at Seventh District banks gross withdrawals of personal savings-type deposits rose sharply in August.

Banking and credit developments in the Seventh District in recent weeks had been similar to those for the nation, except that the rise of loans in the District appeared to be stronger. Although for the most part District banks had been able to cover their needs in the Federal funds market, there was evidence that a few of the large banks had felt increased reserve pressure since early September. Two of these banks had been borrowing at the discount window rather steadily and one had liquidated bills. For all Seventh District weekly reporting banks, however, sales of short-term Governments were more than offset by purchases of maturities over five years. It was a matter of concern to him, Mr. Scanlon said, that banks, in the face of the yield curve, were willing to handle their portfolios in this way.

Mr. Scanlon was gratified that it had been possible to maintain short rates near the 3-3/8 per cent level without cutting back on total reserves and without forcing up the over-all levels of member bank borrowing any more than had been done. With the mid-September pressures over, this might be more difficult in the period ahead, even with the help of a cash financing and the need to supply reserves seasonally. If the demand for funds continued in sufficient volume to absorb a rising amount of reserves, he would consider some further increase in short-term rates appropriate, but he would like to see that pressure come from the market. It appeared to him, however, that the Committee should still give a relatively high priority to achieving moderate credit growth. The present directive provided this posture, and he would favor continuing it without change other than to eliminate the reference to Treasury financing. He would not favor changing the discount rate.

Mr. Deming commented that since Labor Day much of the Ninth District had had generous rainfall, which insured excellent fall pastures and feed for livestock. A large crop outturn was now virtually assured. For reasons that were not apparent in view of the good weather, the September wheat estimate was below the August estimate, but the wheat crop would still be good. The estimate for corn was 20 per cent more than last year, and for soybeans 30 per cent

more. Thus, the farm sector was in a favorable setting. Available information for August and September indicated that nonfarm activity had expanded in the District in the third quarter, and it seemed likely that this expansion would continue in the fourth quarter, probably at an increased rate.

The District bank credit situation in September showed mixed developments and was difficult to appraise. September loan growth at both city and country banks apparently would be well above normal and about equivalent to last year. Almost all of the gain, however, had come in one week at mid-September when there was a sizable expansion in business loans. It was of interest to note that, measured against a year ago, loans were up 8 per cent at city banks and 14 per cent at country banks. There was no recent information about the composition of loan growth at country banks. At city banks, however, the data indicated that four-fifths of the gain had come in loans to financial institutions other than banks, loans on securities (mainly to nondealers), and loans on real estate. Business loans were up only 3 per cent and "other" loans only 1 per cent. The picture seemed to be one of ample--perhaps more than ample--credit supply.

Mr. Deming said that his position with respect to policy came fairly close to that of Mr. Bryan. His thinking centered more on

reserve availability than interest rates. While he would not resist some upward movement of short-term rates, he would work more on the availability side, which meant veering toward a somewhat lower level of free reserves. He would leave the directive unchanged except for deletion of the reference to Treasury financing.

Mr. Swan said that the Twelfth District had seen a continuation of modest expansion in business activity. In August, total employment in the Pacific Coast States increased slightly more than seasonally, with every major nonagricultural sector except mining showing some gain. However, a still greater expansion of the labor force nudged the unemployment rate up slightly. In the banking area, District banks, after having been net sellers of Federal funds for some time, made larger purchases than sales in the week ending September 25, and borrowing from the Reserve Bank increased substantially during that week. The major banks also expected to be net buyers during the current week. This seemed in considerable measure to be related to a reduction of sales of Federal funds and increased bill purchases on the part of one bank.

Mr. Swan said that the general business situation seemed far from exuberant. The international situation was far from satisfactory, but there had been a few encouraging developments recently. It seemed to him that no change in monetary policy was called for at this point.

The bill rate was reasonably well in line with the discount rate, and he would hope that this relationship could be maintained for the next few weeks. At the same time, he would want to supply reserves to meet seasonal needs quite readily. He would favor no change in the directive except for deletion of the reference to the Treasury refunding.

Mr. Irons reported that Eleventh District conditions were good, with activity at a high level. As to the national economic situation, he felt that the economy was quite strong. Some of the statistical weaknesses in August and early September were traceable rather clearly to developments in the automotive industry and metals. There still seemed to be little change in the international picture.

On the matter of policy, Mr. Irons said that he had been quite well satisfied with developments in the past few weeks. In his opinion, things were at a point where the Committee could seek a lesser degree of ease over the next three-week period. He leaned toward the view that there might be a slightly lesser degree of reserve availability, which might have some effect on the rate structure in the market. While he would provide reserves for seasonal purposes, he doubted the desirability of anticipating seasonal needs or forcing them. He would seek, without being too aggressive, the achievement of a slightly greater degree of firmness in the market; in other words, to get as much of a condition of firmness in the market

as was compatible with a 3-1/2 per cent discount rate. That would mean a Federal funds rate of 3-1/2 per cent and a bill rate closer to 3-1/2 per cent than at the moment. He would not be disturbed by some increase in member bank borrowing or by some decrease in free reserves. In summary, while he would not suggest pushing aggressively to get the bill rate above the discount rate, he would try to achieve the full effect of the 3-1/2 per cent discount rate. What he had in mind could be accomplished within the scope of the existing directive, and he would not change the discount rate at this time.

Mr. Ellis said that the New England economy continued to move along at a pace a bit short of the national record. The Reserve Bank was in the process of tabulating the semi-annual survey of manufacturers' outlook and capital spending intentions, and if equal weight were given to all opinions, he would say that those expecting sales this fall to exceed the previous record were in excess of those foreseeing a decline by a ratio of five to one. Optimism with regard to 1964 sales was even more prevalent. It seemed worth noting that some manufacturers depending largely on defense and space-related outlays expressed concern about the possibility of a drag in coming months as defense and space programs were reviewed.

As to policy, Mr. Ellis said he agreed basically with the proposals made by Mr. Irons. He concurred in the thought that reserve availability could well be a matter of primary concern to the

Committee. Required reserves had been moving along at the top of the staff 3 per cent growth guideline, and total reserves had expanded more than 7 per cent in the past 12 months. This had contributed to a situation where foreign bankers were pointing out that "U. S. corporations have money running out of their ears." In these circumstances, it was small wonder that corporate funds were seeking outlets outside the domestic economy. It seemed possible that depreciation and investment credits might combine with a tax cut to accelerate cash flows to such extent that business firms might be more stimulated to make investments abroad than investments domestically. These considerations led him to concur substantially with the views on policy expressed by Mr. Irons.

Mr. Balderston noted that Mr. Hickman had expressed the hope that perhaps European nations might take steps to lower their interest rates. He thought this unlikely, however; the wage explosion in Holland was giving the Dutch authorities great concern, and what France had done to counteract the wage push was a matter of general knowledge. It seemed to him that one could not count on inflation in Europe relieving the burden on the United States. With an average hourly rate of 71 cents paid by manufacturing industries in France, as compared with $2.45 in this country, even if French wage rates were to rise 10 per cent, that would be almost precisely the equivalent of a 3 per cent rise here. One could not take too much comfort that our

average hourly increase is running somewhat below our average annual gain in manufacturing productivity of 3-1/2 per cent even though the European wage advance is ahead of the productivity increase there. In absolute terms, the wage differential, as distinct from the cost differential, has not been narrowed.

As to policy, Mr. Balderston said that he would subscribe to the position taken by Messrs. Irons and Ellis.

Chairman Martin noted that the Committee was faced again with a division of opinion as to policy. However, it seemed to him that the question involved only a small matter: slightly less ease. If he were doing it on his own, he would side with the position of slightly less ease as being more consistent and more appropriate, but it was not a decision that would either make or break the economy. Since there appeared to be a substantial group that did not want to change policy at all at this time, it seemed to him that it would be wise to recognize that fact and not overplay the thought that the situation could be altered substantially by any very modest shift of policy. Accordingly, he would suggest that a vote be taken on the basis of no change in policy at this time, with the understanding that any members of the Committee who dissented would have an opportunity to record their views in that way. The current economic policy directive to the Federal Reserve Bank of New York would not be changed except to delete "and taking account of the current Treasury refunding operation" in the first part of the second paragraph.

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

Mr. Hayes stated, in connection with his vote, that he did not feel that all policy shifts had to be dramatic. The decision today involved a relatively small matter, but he thought it appropriate to record a dissent on the basis that a modification of policy such as he had suggested would, in his judgment, have some significance.

Upon motion duly made and seconded, and by unanimous vote, section 1(a) of the continuing authority directive was

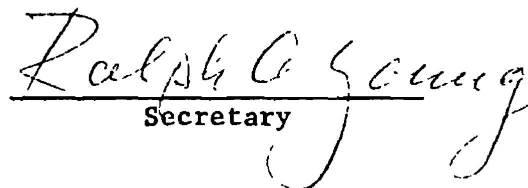
amended, in line with the earlier suggestion of the Account Manager, to authorize the Federal Reserve Bank of New York, to the extent necessary to carry out the current economic policy directive:

(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.

At the suggestion of Chairman Martin, it was agreed that discussion of the memorandum from Messrs. Young and Sherman that had been distributed to the Committee under date of September 28, 1963, regarding the question of making minutes of the Federal Open Market Committee for some past period available in some manner for the use of scholars and others be deferred until the next meeting.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, October 22, 1963.

The meeting then adjourned.



Secretary