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, December 17, 1963, at 9:30 a.m.

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

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

Mr. Molony, Assistant to the Board of Governors
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

Messrs. Sanford, Mann, Ratchford, Jones, and Grove, Vice Presidents of the Federal Reserve Banks of New York, Cleveland, Richmond, St. Louis, and San Francisco, respectively
Mr. Brandt, Assistant Vice President of the Reserve Bank of Atlanta
Mr. Willis, Economic Adviser, Federal Reserve Bank of Boston
Mr. Kareken, Economic Consultant, Federal Reserve Bank of Minneapolis
Mr. Meek, Manager, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on November 12 and November 26, 1963, were approved.

Mr. Mills asked whether it was the thought of the Committee that the decision taken at the December 3 meeting on the procedures for allocation of securities in the Open Market Account should be treated as perfunctorily as it was in the draft minutes, which simply cited the fact that the revised procedures had been approved.

After discussion of this point, it was noted that the draft minutes for December 3 were still open for review and that they could be modified to such extent as might be considered appropriate. In this connection, Mr. Sherman observed that a fuller record of the discussion of the question of possible deficiencies in Reserve Bank reserves against note and deposit liabilities would be included in the minutes of the meeting of the Federal Reserve Bank Presidents with the Board of Governors that took place on the afternoon of December 3.

Before this meeting there had been distributed to the members of 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 December 3 through December 11, 1963, and a supplementary report covering the period December 12 through December 16, 1963. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Sanford commented that the Treasury gold stock this week should remain unchanged for the eighteenth consecutive week. It was likely, however, that the following week would show a sizable decline in order to provide for gold sales expected later this month and in January, which should serve as a reminder that the balance of payments problem was far from being eliminated. In the two weeks since the meeting of December 3 Russian sales of gold had been reduced to comparatively small figures. So far in December, the London gold pool had accumulated only a small amount of gold.

Since the December 3 meeting, Mr. Sanford continued, the System's drawings on the swap arrangement with the Bundesbank had been increased further by a total of $34 million, making the outstanding amount $136 million. The Account's gross debtor position on all swaps was now $376 million and its net debtor position was $326 million.

Year-end window dressing needs of German banks continued during the past two weeks--although there was some evidence in the past few days of their having passed their peak--but capital continued to flow into Germany and that country continued to have a favorable trade balance. Of the Account's drawings of $34 million in the past two weeks $28 million had gone to absorb part of the Bundesbank's takings of dollars, and $6 million had been used for operations in the New York market. With the aid of an expected large German military goods payment later in the month, sizable progress was anticipated in reducing the drawings on the German swap arrangement. The German mark had fluctuated only between $0.2516-3/4 and $0.2517-3/8 in the past two weeks, a bit away from its ceiling, and today the mark had eased a bit.

The Swiss franc had been at or close to its effective ceiling, Mr. Sanford said, reflecting in part year-end liquidity requirements of Swiss banks for Swiss francs. To aid in handling this situation, the Swiss National Bank since December 10 had been buying spot dollars and selling them for one-month forward delivery, meanwhile laying them off to the Bank for International Settlements on a dollar/gold swap. He noted parenthetically that the U. S. Treasury had been extending maturing Swiss franc contracts with Swiss commercial banks.

Mr. Sanford said that for a short while the French franc had been a bit off its ceiling, probably reflecting a development having to do with Euro-dollars and other European currencies about which he would speak later.

The Canadian dollar, which had been holding steady, had tended to ease of late, and the Bank of Canada had sold U. S. dollars to support the rate. This, together with their expectation that they would be further sellers to provide U. S. dollars for conversion of year-end Canadian dividends and for year-end settlements, gave the Account an opportunity to acquire sufficient Canadian dollars from the Bank of Canada to permit complete retirement on December 16 of the swap drawings equivalent to $20 million which were entered into in the latter part of November because of the tragic event of that period.

Mr. Sanford reported that the Euro-dollar market had been subject to considerable pressures in December as a result of the approach of the year end and several extraordinary developments, and rates had moved up--in the case of the 90-day maturity by 1/2 per cent. It now appeared that the Stinnes and Ira Haupt situations, in which Euro-dollars had been providing some financing, had resulted in the development of a more questioning attitude on the part of some who heretofore had deposited dollars in the Euro-dollar market; there had even been some indications that U. S. corporations, to some unknown degree, had been pulling back funds. A further indication of the pull-back of funds, which always occurred, however, to some degree at the year end, was that Japaneses banks had had $100 million of Euro-dollars withdrawn from them, with closely corresponding effects on Japanese official reserves.

Mr. Sanford said the French development that he had mentioned earlier had taken the form of a warning by the Governor of the Bank of France to the French market calling their attention to several factors, including (1) that operations effected on the Euro-currency markets, entailing as they did serious risks, could not be considered as current transactions in the foreign exchange markets but only as credit operations which must be handled with at least the same care as operations transacted for the benefit of French residents; (2) the duration of investments was to be adapted to that of the borrowings; (3) it was well known that some countries, and in some countries some business enterprises, made excessive, and therefore generally dangerous, use of all funds borrowed abroad. The Governor of the Bank of France pointed out in the warning that the French authorities had taken the necessary measures to prohibit such errors by French enterprises. French banks also had to abstain in their own interest, as well as in the general interest, from granting excessive facilities to banks or business enterprises established abroad, about which they did not always have sufficient information, especially since it also was known that the exchange thus lent was often re-lent to third parties in that same country or elsewhere. Mr. Sanford added that there had been criticism in France of the tenor of the warning, since it was held that only one French bank had suffered losses.

Mr. Daane mentioned that there had been confirmation in Europe during the past week, particularly from the Japanese, that the flow of new funds into the Euro-dollar market was drying up, and he asked whether this had been reflected in the U. S. balance of payments figures. Mr. Sanford replied that it was not possible to isolate the effects of such a development in the weekly balance of payments reports. It was reflected, however, in transactions in the New York money market; the Japanese government, for instance, was selling U. S. Treasury bills to provide funds for Japanese commercial banks to repay Euro-dollar loans they were unable to renew.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period December 3 through December 16, 1963, were approved, ratified, and confirmed.

Mr. Sanford recommended that the swap arrangement with the Bank of Canada in the amount of $250 million, which matured December 27, 1963, be renewed. Noting that this arrangement had been renewed every three months since its inception in June 1962, he recommended placing it on a one-year basis while maintaining at three months the drawing provision which was, of course, subject to mutual agreement. He indicated that this would tend to simplify procedures and to remove some existing confusion when both the swap arrangement and the drawing provision were on a three-month basis, and that it would be a further indication to outside observers that there was indeed a strong and continuing solidarity between the central banks. It was believed that the Bank of Canada would find a one year renewal of the swap arrangement satisfactory, Mr. Sandford said, and he noted that the arrangement with the Bank of England was for a one year period.

Mr. Mills commented that a one year arrangement with Canada or any other country might well extend through a period in which a change in government occurred, and the arrangement would thus be fixed for the advantage of a succeeding government whose thinking and policies might be of a quite different kind from those of the government in office at the time the arrangement was made.

Mr. Sanford agreed that such a situation could arise. But, he observed, each drawing was limited to a period of three months and would be entered into only on mutual agreement of the parties. Thus, the System as well as the other central bank involved had to agree to a drawing before it could be made.

Mr. Ellis asked whether the logic supporting the extension of the Canadian arrangement to a one year period would apply to all swap arrangements. Mr. Sanford expressed the view that it would apply to a number of them, but not necessarily to all. He felt the Committee might not want to move to a one year basis for some of the newer arrangements under which there as yet had been little experience, but it probably would be thought desirable to extend others to one year as the occasion arose. A one year basis indicated considerably more solidarity between the central banks and, incidentally, it substantially reduced the amount of paper work required.

Mr. Hickman suggested that an intention to change the amount of a particular arrangement might provide a reason for not lengthening its period, and Mr. Sanford agreed. However, he noted, in the past the amounts of particular 3- and 6-month arrangements had been changed during the period of the arrangement.

Mr. Mills commented that while it was theoretically possible to refuse to agree to a particular drawing under a one year swap arrangement, to do so might lead to a charge of bad faith, since a commitment for one year had been made. He did not question extension of the Canadian agreement, but he thought that publication of the terms of the arrangements would invite invidious comparisons if some were on a long-term basis and others were not. Such a situation would be impolitic and difficult to handle, in his judgment.

Chairman Martin commented that the Committee had already started in this direction by placing its arrangement with the Bank of England on a one year basis.

Mr. Hayes considered it likely that the Committee would eventually want to go to a one year basis for many of the agreements, but he saw no necessity for determining the matter at this time.

The Chairman then suggested that the Committee vote on the recommendation with respect to renewing the Canadian arrangement for a one year period, with the understanding that no precedent would be established if the Committee approved the proposal.

> Thereupon, renewal of the swap arrangement with the Bank of Canada for $250 million for a one year period was approved.

Mr. Mitchell commented that frequently the recommendations of the Special Manager came to the Committee without advance notice. Sometimes this was unavoidable, but on other occasions it would be possible for the Committee to be advised in advance that a certain recommendation was going to be made. It seemed to him that with such advance notice the Committee could dispose of the Special Manager's recommendations more effectively and expeditiously.

Chairman Martin suggested that the Special Manager work with the Committee Secretariat to see what could be done along such lines.

In further remarks, Mr. Sanford advised, for reasons which he outlined, that there was no progress to report on the matter of a possible increase in the swap arrangement with the Bank of France.

Mr. Sanford also mentioned that drawings on the Netherlands Bank swap arrangement of $20 million and $60 million equivalent in guilders would mature on December 27, 1963, and January 2, 1964, respectively, and drawings on the B.I.S. of $50 million and $25 million equivalent in Swiss francs would mature December 30, 1963, and January 7, 1964, respectively.

To the extent that it was not possible to reduce these drawings by their respective maturity dates, it would be necessary to seek renewal for further three-month periods. These would be the first renewals of these particular drawings.

In reply to a question, Mr. Sanford said the drawings in question originally had been made in late September and early October, and earlier drawings of guilders and Swiss francs had been repaid before these drawings were made.

The proposed renewal of the drawings, to such extent as might be necessary, was noted without objection.

Before this meeting there had been distributed a report from the Manager of the System Open Market Account covering open market operations in U.S. Government securities and bankers' acceptances for the period December 3 through December 16, 1963. A copy of this report has been placed in the files of the Committee.

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

> There is little to add to the written reports regarding developments in the brief period since the last meeting. In this period the money market coped quite readily with what has sometimes been a period of considerable seasonal strain. In some recent years, the advent of December dividend and tax dates has thrown a large volume of financing needs back on the banks as dealer repurchase agreements with corporations

ran off, forcing the dealers to turn in size to the banks which were at the same time experiencing direct pressure from increased business loans around the tax date. This time, the money market banks were well prepared for these additional demands, and perhaps even over-prepared for the demands that emerged in the first half of the period, with the result that the money market was unexpectedly easy. Also contributing to the facility with which the market handled the seasonal demands made upon it this year is the fact that dealer positions and use of credit had recently been running on the order of $800-$900 million less than a year ago.

Later in the interval a firmer tone returned to the money market, and yesterday--the quarterly corporate tax date--there was evidence of some sizable pressure of the sort that had been anticipated earlier. Thus, where the System had been absorbing reserves through the first part of the period, in order to help restore a firmer tone, the System supplied a sizable volume of reserves yesterday to provide some lubrication over the tax date itself.

The temporary easing in the money market had little impact in the securities markets beyond the Treasury bill area. Bills edged lower in rate through the first half of the interval and then returned to about the same level as two weeks ago, with the three-month issue remaining in a range of 3.50-3.55 per cent. The average issuing rates in yesterday's auction of about 3.54 per cent and 3.68 per cent for the 3- and 6-month bills, respectively, were within a basis point of the rates two weeks ago.

In the bond market, as the shock of the assassination receded further in time, the market gave increasing attention to economic factors that are expected to affect interest rates in the months ahead. In particular, attention has been given to the continuing indications of good business, rising loan demand, and the prospect that an early tax cut may both stimulate business and temporarily enlarge the Treasury's deficit. The market has also noted the recent rise in yields on high-grade corporate bonds. Finally, the market remains aware that the balance of payments problem is still far from solved. The downward drift in prices in response to these factors has been quite orderly, however, with no great pressure of selling reported.

The corporate and municipal bond markets showed little change in price during the recent period, following the declines that had occurred earlier. Investors showed selective interest in new issues, with some of the larger offerings winning only fair response. Considerable attention is focusing on two major negotiated offerings that are expected to reach the market today--$150 million of Sinclair Oil bonds and $100 million of Bankers Trust capital notes. Rate expectations for the Bankers Trust issue are in the neighborhood of 4.45-4.50 per cent, while the Sinclair bonds are expected to come at a slightly higher level.

Near-term prospects for Treasury financing include the sale of another billion dollar one-year bill, probably on December 30; replacement of the $2.5 billion maturing January 15 bills--possibly with a like amount of June tax bills; and the raising of another $750 million--$1 billion of cash in mid-January--perhaps through a note or short bond. Toward the end of the month, the Treasury will choose the terms of the refunding of its February 15 maturities, of which a little over $4 billion are publicly held.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period December 3 through December 16, 1963, were approved, ratified, and confirmed.

Chairman Martin then called for the staff economic and financial reports, supplementing the written reports that had been distributed prior to the meeting, copies of which have been placed in the files of the Committee.

Mr. Brill commented on economic conditions as follows:

Optimism about the economic outlook continues to abound, in fact to increase with the apparent improvement in prospects for the tax cut. It is getting more and more difficult these days to characterize our profession as the "dismal science."

This nigh-universal optimism carries with it some obvious dangers. When everyone is convinced that there is "no way to go but up" such an orientation can easily spill over into attitudes towards wages and prices. Thus, even with unutilized capacity and manpower, we have been getting continued testing of markets by businessmen through scattered price increases--fortunately, not all of which hold--and mutterings from labor leaders about the kinds of contracts they will fight for next year.

In the context of such exuberant psychology, it may be salutary, as an antidote, to stress some of the deviations and lapses from progress, when and where they occur. The wage and price stability we have enjoyed in this expansion is explainable principally in terms of fundamental supply and demand relationships, but I am sure the occasional pauses in the uptrend have also been influential in preserving economic sobriety. Hesitations in the pace of expansion have introduced just enough uncertainty to help keep inflationary psychology from reviving, at least outside of the stock market and some parts of the real estate market.

November can fairly be described as one such pause in the general updrift, even if its import has not yet been fully assimilated by the optimists. There was not much economic progress last month. Industrial production edged up only slightly, not enough to move the index out of the rounded 127 level achieved in October. Retail sales also remained at about October levels, if one makes rough allowance for the effects of the national tragedy on November 22. Employment remained essentially unchanged and the unemployment rate bounced up. Construction activity was high but no higher than in October, and businessmen reported that their current spending for plant and equipment was not rising as much as they had anticipated three months ago and that they foresaw no rise from present levels in the immediate future.

November developments, then, should be sobering, and even more so if put in a somewhat longer perspective. Industrial production at 127 is, after all, only barely higher than the index for July. Nonfarm employment has grown quite moderately since July, and retail sales in November were also no higher than mid-year levels. If it were not for the continuing $8 or $9 billion per quarter gain in total GNP, one might venture a judgment that the pause in economic expansion really began back at midyear. Momentum in the broad GNP aggregate has been maintained in large part by exceptional--perhaps unsustainable--increases in both private and State and local government construction activity, and by a continued rise in consumer and Government spending for services.

I would not want to overdo the contrast between leveling off in the industrial sector of the economy and continued expansion in other components of total economic activity. We could be the victims of inadequate or inconsistent seasonal adjustments among the various measures. One should note a similar divergence between the production index and the broader GNP measure in the latter part of 1962, which was followed by an upsurge in production earlier this year. One should also note that in both years the late summer and fall credit figures--particularly business loan demands--appeared more consistent with the expansive pattern of GNP than with the stable pattern of the production index.

Whether the recent course of the economy actually has been sidewise or moderately up may be debatable, but this is of less importance than the clear evidence that we have not been in a strong boom. Given only modest progress at best, in recent months, and given still substantial margins of unutilized resources, there does not appear to be much reason for expecting that a tax cut will necessarily produce a "bubble on a boom" of the sort we got in 1955, when rising Government expenditures were overlaid on rising private demands.

Not that this insures us against inflationary effects. We have had earlier experience with rising price levels well before full employment or full capacity utilization was achieved. But, as Chairman Martin recently pointed out, there also is another risk--the risk that an economy having already sustained a three-year expansion might not respond vigorously to a tax cut stimulus. Current evidence suggests that either possibility is still very much alive. It would be premature, therefore, to adopt policies consistent with only one alternative. Until the economy more clearly commits itself to one course or another, a policy of watchful waiting continues to be appropriate.

Mr. Holland made the following statement with regard to the financial situation:

The financial system is deep in the throes of its usual December churning, and the final outcome is still uncertain. The tax date is past, but the remaining two weeks of the month can still generate some substantial pressures, as the sharp but temporary upsurges of demand for bank credit and reserves in the last two weeks of 1961 and 1962 can testify. To date, however, one must say that the December tax and dividend pressures had been surmounted fairly easily. First reports from leading New York City banks suggest that customer borrowing on the tax date yesterday was somewhat heavier than usual, but not extraordinarily so. Bank borrowing at the discount window moved up somewhat this week, but up to the tax date, it was still below the average November level. The money market generally also has been in a comfortable position during most of December. Mr. Stone has already commented on a number of the factors contributing to this result, and I would add mention of the sharp reserve redistribution from country to city banks.

Underlying the immediate market factors, there seems to me to have been some recent softening, at least for a time, of the strong pressure of credit demands upon the banking system that was occurring earlier this fall. Bank earning assets have continued to expand in late November and December, but important portions of the week-to-week increases at city banks have represented special financing arrangements, or additions to bank portfolios of bankers' acceptances, Treasury bills, or securities loans made when a bank found itself with temporarily surplus reserves. The more liquid of these acquisitions ought to be fairly quickly disgorged as member bank borrowing climbs back up into the $300-$400 million range.

A counterpart to these changes in bank earning assets has been a slowdown in bank deposit growth and reserve utilization. Seasonally adjusted required reserves against private deposits have been drifting irregularly lower ever since their early November jump. Money supply appears to have leveled off in the second half of November and first half of December, following its early November bulge. Time deposit expansion also seems to have slowed in December after the big November expansion when city banks bid so aggressively for C.D. money. Part--but only part--of this moderation of private deposit growth can be traced to transfers to Government deposits, which have been climbing somewhat more than usual since the end of October. But the rest of the explanation must lie elsewhere. Partly it may lie in imperfections in the seasonal adjustments being used. Partly also, it may reflect a pause for some digestion of the sharp deposit and credit increases that have occurred since August. Such a pause is not unreasonable to expect. We have had them before; they often have been brief, and sometimes have been succeeded by a vigorous new upward push.

If in fact that vigorous upthrust is able to reassert itself against the ebbing seasonal tides of the new year, I think an important threshold for policy will have been reached.

While the configuration of expansion in the banking system was shifting, adjustments of other kinds were proceeding elsewhere in the credit markets. In most markets in which credit instruments are traded (the chief exception being the mortgage market) interest rates have had a tendency to show more movement in November and December, both upward and downward. The timing has varied from market to market, and the causes of rate fluctuations have not always been the same. In the short-term markets, the chief factors have been shifting reserve availability and changing expectations as to official intentions. In longer term markets, rate movements have been conditioned more by changing supplies of new offerings, and, increasingly, by expectations as to the likely trend of rates in 1964.

Whatever else their effects, the recent rate fluctuations in the short-term area have had the therapeutic value of shaking up complacent market assumptions of an official "rut" for bill rates and Federal funds rates, and this has correspondingly broadened market ideas of the range within which rates may be expected to fluctuate under any given monetary policy in the future. This may be of explicit help next month, for it gives the Account Manager slightly greater leeway for permitting market-induced fluctuations in short-term interest rates during the lengthy succession of forthcoming Treasury financings. As Mr. Stone has suggested, the Treasury plans to be involved in the market in some respect or another on every day from December 30 through February 15, excepting for the reserve week from January 23 through 29. To be sure, the Treasury and market participants will need the protection of a System "even keel" policy more during some of these intervals than others. But, by any stretch, the openings for any intervening change in monetary policy are uncomfortably slim.

There are, it should be noted, two ways in which monetary policy will benefit from this concentrated Treasury schedule. It will sweep the calendar clean of any further necessary Treasury offerings until the May 15 refunding. An advance refunding in March is a possibility, but that offering is discretionary with the debt managers. Second, the Treasury will be supplying a net $2 billion of longer bills to satisfy seasonally strong investor demands, thereby moderating the possible downward tendencies in bill rates. This addition to bill supplies is about the same amount as was added by the Treasury during the first two months of 1963, but it will be concentrated much earlier in the coming season, and should correspondingly postpone any tendency for bill rates to drop to levels that might be regarded as undesirable for policy purposes.

I recognize that several of my foregoing comments suggest the possibility that both the need and the opportunity for a further shift of monetary policy could emerge by mid-February or thereafter. It would be presumptuous--even foolhardy--of me to forecast such a juncture. But this is one eventuality that the Committee will want to watch for.

Mr. Furth gave the following report on the balance of payments:

The payments deficit for the current quarter will be larger than that for the third quarter but probably still much smaller than for the first two quarters of the year.

The October figure was revised upward by $100 million to $300 million, owing to a reporting error of a large bank; there is nothing the Federal Reserve can do to avert such errors, and the resulting misinterpretations of the payments trend--except to urge the reporting banks again and again to be more careful.

The preliminary November figure also indicates a deficit of about $300 million; this result is rather encouraging not only because November--like October--apparently saw a net flow of window-dressing funds to Canada but also because the murder of President Kennedy probably led to some outflow of U.S. funds.

The first December week produced a very large surplus, suggesting a reflux of such volatile funds. The second week showed a moderate deficit but the tentative nature of the weekly data precludes the projection of the figures for the second half of the month. Moreover, the next weeks will see two types of transactions with opposite effects on the U.S. payments balance: outflows of window-dressing funds to Europe--which have already begun--and receipts of year-end payments on the debts owed by the United Kingdom and some other countries to the U.S. Government. Incidentially, insofar as European banks used Euro-dollars borrowed from foreign residents rather than dollars borrowed from U.S.

residents for window-dressing, their transactions would not affect the U.S. payments balance; but the dollar would still be under pressure in European exchange markets as commercial banks sold the dollars to their central banks.

The Euro-dollar market seems to have contracted in recent months, owing both to a more critical attitude of European central banks and to the failures of financial enterprises here and abroad that had large Euro-dollar commitments. It remains to be seen what influence, if any, a sizable contraction would have on U.S. international liquidity. Withdrawal of U.S. corporate funds would reduce the U.S. deficit, as presently calculated, except insofar as the resulting rise in interest rates abroad led to increased foreign borrowing from U.S. banks. But the withdrawal of dollars now put into that market by foreign bankers or traders would swell the dollar holdings of foreign central banks and could thereby cause larger foreign gold purchases from the U.S. Treasury.

The economic position of most foreign countries remains encouraging. The same thing cannot be said, however, for the policies of some of the most prosperous countries. In spite of its large payments surplus and the absence of domestic inflation, the most liberal and internationally-minded European nation, Germany, maintains a level of interest rates that attracts capital from all over the world; last summer it raised its import barriers by increasing compensating taxes levied on imports; and now it is planning to subsidize its exports by means of changes in its system of tax rebates.

The European Economic Community as a whole seriously contemplates an increase in its steel tariff, and it still has to decide whether its agricultural policy will or will not be consistent with expanding world trade in agricultural commodities.

If protectionism is going to emerge victorious from these decisions, the result may well be a trade war between the Community and the rest of the world, with serious consequences for the very existence of the Community and for the economic cohesion of the free world.

A revival of beggar-my-neighbor policies in international trade might well nullify the gains in cooperation achieved in international finance, and thereby add to the difficulties of defending the dollar.

Chairman Martin then called for the usual go-around of comments and views on economic conditions and monetary policy beginning with Mr. Hayes, who commented as follows:

Nothing has occurred in the last two weeks to change our assessment of the current business situation and outlook. Both continue to be quite favorable, even though there are some uncertainties, especially with respect to next year's business outlays on plant and equipment, and even though the unemployment problem seems as intractable as ever. The growing indications that the tax bill will be passed early in the year constitute an important element of strength. Mild upward price pressures are in evidence, particularly in industrial raw materials--but these faint signs are still far from conclusive evidence that a major price break-out is under way.

Our balance of payments statistics continue to make disappointing reading. The final October report now shows a deficit of $315 million, with the November figure estimated to be almost as large. Now that some details for October are available, it appears that both short-term capital outflows and a shrinking trade surplus contributed significantly to the deficit for that month. It is disturbing to see the over-all deficit remain at such a high level despite the virtual cessation of purchases of newly-issued and outstanding foreign securities. While the situation in the foreign exchange markets is fairly satisfactory--except for the strength of the German mark and the German balance of payments--the possibility of renewed pressure on the dollar is clearly present.

The over-all statistics on bank credit point to continued rapid expansion in this series, with the $3 billion gain in November the third largest this year. The 7.6 per cent annual rate of gain in bank credit in the first eleven months of 1963 was only slightly less than the 8.5 per cent rate of gain for the corresponding period of 1962. Bank loans, including business loans, again showed substantial increases; and while part of the rise in loans appears to have been attributable to special factors, it is hard to avoid the conclusion, especially in the light of comments around this table at the last few meetings, that underlying loan demand has strengthened considerably in recent months. Nonbank liquidity registered a further sharp advance in November, with sizable gains in both money supply and time deposits. On the other hand, it may be worth noting that in the past two years the banks have materially lengthened the average maturity of their portfolio of Governments--so that further loan expansion could put greater upward pressure on long-term interest rates than has been true in earlier periods of loan expansion.

As we consider the possible need for policy modifications in the months immediately ahead, we cannot overlook the fact that the next couple of weeks provide perhaps greater freedom of action to the System than any other prospective period until some time in March. The financing calendar for January is fairly full, and in the latter part of that month the February refinancing will be announced. This in turn may well be followed closely by an advance refunding that will extend well into March.

On most of the occasions during the past two years when we have seen fit to move modestly toward lesser ease, the Committee has rightly felt some reluctance to do so in view of the then position of the domestic economy. Today, however, I think we are in a different situation. Not only is a further modest move in this direction clearly indicated as desirable by the continuing balance of payments problem, but there also is real justification for asking ourselves whether the recent growth rates for bank credit and nonbank liquidity have not exceeded optimum levels even from a purely domestic standpoint. We have had several warnings in the market that further credit expansion at the present high rate may have decidedly undesirable consequences for credit standards. I doubt whether any of us, when we modified policy a year ago and five months ago, had any idea that bank credit would keep on growing as fast as it has.

It seems to me highly appropriate that in the next three weeks we should seek to encourage a somewhat reduced rate of bank credit growth by allowing credit demands to put somewhat greater pressure on bank reserve positions. Thus, free reserves might be allowed to fall moderately--possibly to about the zero level. I can see no harm at all if the result is to push bill rates somewhat above the discount rate--perhaps to the 3.60 per cent level--although, as seasonal pressures wane, we may have difficulty keeping the rate much above 3-1/2 per cent. The serious balance of payments outlook warrants our continuing to give careful attention to the bill rate, over and above the proposed objective of slowing the rate of credit growth.

If the Committee should agree on the soundness of these objectives, the second paragraph of the directive might well be amended slightly, first to eliminate the reference to possible market unsettlement, which no longer seems needed, and second to suggest a slightly greater degree of firmness in the money market and a slightly slower rate of reserve expansion.

Mr. Shuford said there had been no significant changes in economic activity in the Eighth District since the Committee meeting of two weeks ago. For the year as a whole the District had had marked improvement, but there had been little change since August. Total employment in the District's major labor markets had increased only slightly from the high level reached in July. Since August industrial use of electric power had been about unchanged and similarly with bank debits.

Total loans of weekly reporting banks showed a considerable increase from August to November with most of the increase in business loans to commodity dealers and food, liquor, and tobacco processors. Funds to accommodate this loan expansion had come from a net sale of securities and a growth in deposits, mainly time deposits.

Noting that the national economy had been discussed fully this morning, Mr. Shuford said he would simply mention that after reaching a high level in mid-summer activity had increased at a somewhat more moderate rate. Industrial production recently had been only slightly above its July level in contrast to a 12 per cent annual rate of expansion from January to July. New construction expenditures, after increasing rapidly from the first of the year to August, were down somewhat in September and October and appeared to be little changed in November. Economic strength did appear in some areas such as personal income, which in November continued the steady rise of the past twelve months. The latest data for corporate profits and for plant and equipment expenditures were strong.

Mr. Shuford commented that monetary policy over the past year seemed to him to have been reasonably appropriate. Committee actions had permitted a higher level of short-term interest rates, which had contributed to a somewhat improved balance of payments situation. At the same time, policy had facilitated the improvement that had occurred in economic activity by providing reserves for a relatively rapid growth in bank credit and the money supply.

Mr. Shuford said he agreed with Mr. Hayes that the balance of payments problems had not been resolved and could become more severe. It was also true that the rate of increase in the money supply during the past year had been high compared with other recent years and had continued high this fall. However, in view of the moderate improvement in the economy, the relative stability of prices, and the moderate growth in real product, he did not feel that monetary policy had been unduly expansive, considering a period longer than just the past few months. He thought the Committee needed to be very much on the lookout for evidence that monetary expansion might be leading to excessive total demand, but in his opinion there was no clear evidence of this as yet. Accordingly, Mr. Shuford said, he would favor no basic change in policy now. He favored a bill rate fluctuating around the 3-1/2 per cent level in response to seasonal influences both now and after the year end, and a Federal funds rate continuing in the neighborhood of 3-1/2 per cent. He thought reserves should continue to be provided at a moderate rate so as not to unduly hamper economic development. He did not favor a change in discount rate. With respect to the directive, he suggested omitting the phrase referring to the death of President Kennedy.

Mr. Bryan said that Sixth District figures had been behaving about the same as the national figures; they indicated some continuation of the upthrust but perhaps at a slightly decelerated rate. As he looked at the national problem he noted the change from a year ago in the money supply, narrowly defined. The increase seemed to him to have been ample, and in the last three months the rate of increase had been up, not down. The banks recently seemed to have been able to supply a rather sharply increased loan demand while expanding their investments. Also, liquidity in the nonbank sector had risen sharply. The net of it, Mr. Bryan said, was that he could not see on the basis of any reserve figures that the economy had been starved for reserves. On the contrary, if anything monetary policy had been slightly too easy.

With respect to policy for the present, Mr. Bryan said that December was not a time when the Committee could make a change with any confidence, and he would be inclined to favor no change. He would interpret no change in terms of a target figure for free reserves of slightly over zero, but he would not object if they fluctuated back and forth around the zero point.

He had noted comments at this meeting on the price level, Mr. Bryan continued; he did not view price developments with as much equanimity as others, he said, because of the consistency of the upward drift that had been fairly evident in services and now had become evident in commodities. It seemed that some factors had been operating to raise the price level in spite of the unemployment rate and the existence of excess capacity. While the rate of increase in itself did not seem large, when it was compounded over a ten-year interval it produced a surprising figure. Mr. Bryan concluded by saying the directive should be altered by taking out the reference to Mr. Kennedy.

Mr. Bopp said that during the past two weeks there had been small changes in the Third District which pointed, if anywhere, to a slight improvement in the business situation. Some areas had posted gains in manufacturing employment in November, and store sales, after closing out November with another relatively poor week, had picked up during the first week of December.

Two developments characterized Third District banking since the last Committee meeting: continuing reserve pressure and a slackening of the recent strength in business loans. Though down from recent highs, the basic reserve deficit of reserve city banks was still fluctuating around the $100 million mark, reaching $120 million on a daily average basis in the week ending December 11. During the same week, country bank borrowing was $13 million, a relatively high level for recent years. Though total loans and investments were up, business loans at weekly reporting member banks had declined by $22 million. This compared to a $2 million fall in the same period last year.

As to policy, Mr. Bopp felt it important not to be swept away by the extremely optimistic sentiment that seemed to prevail now. Business was better than many people had expected but optimism seemed to have out-run the facts. The pace of expansion remained moderate and was remarkably free of the excesses which characterize booms. The consensus on the outlook was favorable, but the predictions continued to indicate only moderate advances. And it was still far from a sure thing that business would escape a downturn next year.

For these reasons, Mr. Bopp said, the Committee should not move any further away from ease. In any case, the present period, with seasonal pressures in force, seemed an inappropriate time for such a move. It was important to see how vigorous business remained during the winter months and as action on a tax cut moved nearer. Moreover, time would reveal whether the recent improvement in the balance of payments was temporary or not.

In sum, Mr. Bopp said, he would make no change in over-all policy; he would not change the discount rate; and except for deleting the reference to President Kennedy's assassination he would make no change in the directive.

Mr. Hickman said that, as was to be expected, not much had been added to the understanding of the business situation since the last meeting of the Committee. Output continued to expand moderately. The latest projections on plant and equipment spending, as announced by Commerce-SEC, were reassuring as to trend, although somewhat disappointing as to level. The news of a slippage of retail sales in November had been anticipated, and fragmentary evidence for December suggested a strong rebound. Contrary to some expectations, the preliminary report on seasonally adjusted corporate profits for the third quarter showed a rise from the second quarter.

This might be a good occasion, Mr. Hickman commented, to catch up on the most recent wrinkles in the auto and steel industries. Two schools of thought seemed to be emerging in the automobile trade--one bullish, one bearish. The bears felt that sales were not sufficiently strong to sustain current output rates over the near future. They foresaw a cut on the order of 10 per cent in the production rate in early 1964. The bulls pointed to a shift of consumer preference towards cars in the middle-range price bracket, coupled with the fact that inventories had been particularly tight among dealers in such cars. As more cars become available, it was argued, they would be sold, and the current high level of output maintained.

In the steel industry, inventory liquidation appeared to have proceeded more rapidly than expected, Mr. Hickman reported. Ingot output and shipments were rising contra-seasonally and were lending support to the adjusted index of industrial production. Only a month or two ago observers had been prepared for a decline in the steel industry, at least of seasonal proportions.

Mr. Hickman said that money and credit developments of the last two weeks had continued essentially along the lines of the recent past except for an occasional inadvertent easing of the money market, associated, as Mr. Holland had indicated, with a maldistribution of reserves. If the Committee was trying to maintain an invariant free reserve target of about $100 million--and he took it that such was Committee policy--this sort of thing was to be expected. In view of the touch-and-go situation in the foreign exchanges and uncertainties regarding future developments in foreign money market centers, Mr. Hickman said, any tendency towards ease, even occasionally, ran the risk of encouraging outflows of short-term funds from New York.

From time to time, Mr. Hickman continued, he had been disturbed over the extent to which spokesmen outside the Federal Reserve System appeared to be speaking for or committing the System in its future policy. For that reason, he was particularly pleased by the recent statements of Chairman Martin and Mr. Hayes before the International Chamber of Commerce. It seemed to him that their words described accurately and forcefully the appropriate monetary policy for present circumstances. Furthermore, to him their statements served to reaffirm the central responsibility of the Federal Reserve System in the determination of monetary policy.

Mr. Daane said that before participating actively in the Committee's policy deliberations he would like to have a chance to reorient himself on System thinking and to study the considerations that had gone into the formulation of monetary and credit policy in recent months. Accordingly, he would make no policy recommendations at this meeting.

The Chairman noted that Mr. Daane had just returned from a meeting of the "Group of 10" in Paris and invited him to comment. Mr. Daane replied that he would be happy to say a word about how that Group was progressing and where it was heading. By way of background, he noted that at this year's meeting of the International Monetary Fund in Washington the 10 nations participating in the "General Arrangements to Borrow" had reached an agreement described in the following quotation from a press release issued on October 2, 1963, by Secretary Dillon on behalf of the "Group of 10":

> "In reviewing the longer-run prospects, the Ministers and Governors agreed that the underlying structure of the present monetary system--based on fixed exchange rates and the established price of gold--has proven its value as the foundation for present and future arrangements. It appeared to them, however, to be useful to undertake a thorough examination of the outlook for the functioning of the

> international monetary system and of its probable future needs for liquidity. This examination should be made with particular emphasis on the possible magnitude and nature of the future needs for reserves and for supplementary credit facilities which may arise within the framework of national economic policies effectively aiming at the objectives mentioned in paragraph 2. The studies should also appraise and evaluate various possibilities for covering such needs."

The representatives of the Group to whom this study had been entrusted had held two meetings in October during the week of the Bank and Fund meetings and another meeting in Paris on November 5 and 8; and had just completed still another meeting in Paris on December 13 and 16. Further meetings at the ends of January and February were scheduled. The purpose of these meetings, Mr. Daane said, was for the participants to have full and frank discussions of their individual views while remaining noncommittal with respect to the positions of their governments. It was tentatively planned to hold a week-long meeting in Washington during the second week of April in the course of which these preliminary expressions of individual views would be translated into negotiations, with deputies of the Group of 10 then expressing the views of their governments. Under this schedule the period from the end of February to the second week of April would be available for the governments to resolve their own positions. Subsequent meetings were planned for mid-May and mid-June for the purpose of preparing a preliminary report to be submitted to a meeting of Ministers in June, for possible review at a Ministerial meeting in Tokyo in September.

The representatives decided that their preliminary report could begin usefully with a review of the reasons for the exclusion from their discussions of two subjects--namely, changes in the price of gold and fluctuating exchange rates. The Group's secretariat had been asked to assemble materials for this purpose, and the U.S. representatives had contributed papers setting forth the assumptions underlying the exclusion of these subjects.

The study itself involved three main topics: the functioning of the international monetary system, future needs for liquidity, and the means of covering these needs. Much of the discussion so far had been concerned with the functioning of the monetary system, although the group had begun to get into the question of liquidity needs. The sources of liquidity had been broken down into three components: gold, reserve currencies, and credit. As to gold, the Bank for International Settlements had submitted two background papers--one on the prospective growth of gold reserves and the other on cooperation among central banks in the gold market. There had been some preliminary discussion of these two papers at the most recent meeting, and it was expected that there would be wider discussion as the work of the Group progressed.

As to the reserve currency component of liquidity, Mr. Daane continued, the deputies had been invited to submit notes on their views of the role of reserve currencies in the present international monetary system, with particular attention to how the reserve currency system was working and whether its replacement might be desirable eventually. The U.S. representatives had submitted a paper on this subject which had been considered at the recent meeting along with the submissions of other countries.

Several broad currents of European thought seemed to be coming through, Mr. Daane said. There was considerable feeling that agreements should not simply be bilateral, but should come under multilateral review. There also was considerable feeling in favor of reducing present holdings of reserve currencies and increasing holdings of gold, and some feeling in favor of either supplementing, or substituting for, reserve currencies by a composite reserve unit including a gold component.

Mr. Daane concluded by saying that the participants in these meetings felt free to express their own views and tended to be provocative in their remarks. Their statements, of course, did not commit their governments to any particular courses of action. He thought that the direction the study ultimately would take would be much clearer after the April meeting, when it would be learned how serious some of the individual country submissions were in terms of government positions.

Mr. Mitchell said that it seemed to him the performance of the real economy in the past 6 months had not been very strong, certainly not if judged by the course of industrial production. On the other hand, the economy had been relatively free of disequilibrating tendencies so that, for a lackluster performance, it had behaved desirably.

The credit economy was something to which the Committee was more sensitive, Mr. Mitchell observed. He noted that there had been much concern expressed about the quality of credit, but he had not seen any evidence that the quality of credit extended by banks had deteriorated to the point where it jeopardized bank reserves in any sense. In any event, he doubted that it was possible in a free enterprise economy for monetary policy to do much about the quality of credit, which depended on the nature of the many individual decisions made by loan officers on the ground. In his judgment a policy of restricting available funds and pushing interest rates up would result in a deterioration of the quality of credit rather than an improvement.

On the balance of payments, Mr. Mitchell said, it was true that there recently had been disappointing news. However, he thought the Committee should recognize that monetary policy would not solve the problem except insofar as it helped to stabilize the price level. Any effects through short-term interest rates simply postponed the day of judgment, and it was a mistake to think that such rate effects accomplished more than this.

Mr. Mitchell commented that in his opinion some of the people at the table were taking a rather unsophisticated view of the price level and price indexes. It should not be surprising, he said, that the wholesale price index remained stable despite reports that many businesses were testing markets and trying to raise prices. As the Stigler Committee had indicated, the wholesale price index utilized price quotations rather than prices actually charged, with the result that much actual cyclical movement was not reflected in the index. In his judgment, however, the price movement that was occurring was not of a type to call for monetary policy action. The consumer price index had a different defect: it failed to take account of quality changes. He thought one could say with confidence that if such changes were accurately measured the index would not suggest that there had been an upcreep in consumer prices recently.

Mr. Mitchell concluded by saying that on the basis of these thoughts and on the basis of the analyses presented by the staff, he would favor no change in the Committee's present posture. He would amend the directive to take out the phrase referring to President Kennedy's death.

Mr. Shepardson said that he recognized the divergent trends that were mentioned in Mr. Brill's review. On the other hand, while it seemed to him that some factors were not as exuberant as many of the Committee members might like, he would be inclined to give more weight to the affirmative factors than Mr. Brill had. He would admit to taking an unsophisticated view of price developments; he shared Mr. Bryan's concern that the Committee was not giving enough attention to the upward crawl of prices. The decline in beef prices had masked the rises occurring in prices of other commodities. Pressure on prices was continuing, and while some increases were not sticking others were.

There had been a constant upward movement in the consumer price level, Mr. Shepardson continued, and this would be reflected in wage negotiations in 1964. He agreed with Mr. Mitchell that price level changes would have a significant effect on the balance of payments problem.

With respect to the outlook, Mr. Shepardson commented that this season, near the year end, was not the best time to gauge the situation. Normally there was some slackening after Christmas and it was hard to say what the next few months might show. It seemed to him the Committee had met seasonal reserve needs fully, if not more than fully. Required reserves continued to be above the staff guidelines and there had been a significant run-up in the money supply. There had not been the upward pressures on interest rates often associated with the Christmas season, which indicated that the Committee had more than adequately met all needs.

At this point, Mr. Shepardson said, with the run-off that usually started at Christmas and continued for some time afterwards, it was particularly important that the Committee not lose ground. As Mr. Hayes had mentioned, it might be difficult to work against the seasonal slack after Christmas, but every effort should be made to avoid any sloppiness in money markets. It was likely that the Committee might want to take significant action in the near future, and would need solid ground for such action. He did not recommend a significant change in policy at this time but did urge that the Committee hold firmly to the money market conditions that it had had recently. It would not be undesirable for free reserves to fall to zero, and the bill rate might be held at or somewhat above its present level.

Mr. Robertson made the following statement:

> Both business and financial activity seem to have settled back to a more moderate rate of expansion, following their more vigorous advances earlier this fall. If this change of pace represents simply a pause to consolidate gains preparatory to further advances, I suppose we all would be satisfied. If it should prove to be a longer lasting loss of momentum, however, there is reason for concern. We still have plenty of resources that need to be put to work, and the November figure on unemployment is a harsh if somewhat unreliable reminder to that effect.
>
> I know we are all watching the price indexes closely for any signs of emerging general inflationary pressure, but apparently price increases in some lines continue to be roughly counterbalanced by offsetting if less publicized decreases elsewhere. Presumably this kind of happy coincidence will have to stop some time, but I do not believe we can risk trying to forecast that timing. Three years ago, no one would have forecast that our economy could boost its GNP by roughly $100 billion without any major accompanying movement of wholesale prices, and I think that development should make us appropriately humble about our ability to guess how much longer it can go on.
>
> So long as we continue to have a noninflationary economic expansion, I favor encouraging it with a broadly stimulative monetary policy. In particular, during these

days of peak seasonal pressures I would direct the Manager to provide the reserves needed by the market without any show of reluctance, and I would caution him not to be premature or overaggressive in mopping up the return flow of reserves after the holidays.

I would not think this prescription should produce any great and sustained interest rate decline over coming weeks, unless business activity softens, but it probably would allow for moderately greater interest rate fluctuations downward from their seasonal peak. This I think would be to the good, for it could help to dispel some of the easy assumptions about pegged rates that have pervaded financial circles, both at home and abroad. The market developments of the past three weeks have, of course, been a step in this direction, and I hope we can reinforce that lesson in the weeks ahead.

All this I think can be accomplished within the confines of the current directive. Neither domestic nor international considerations seem to call for any overt policy change; and both the seasonal churning in the markets and the forthcoming schedule of Treasury financings provide technical arguments against any change, other than perhaps to recognize these two technical considerations explicityly in the directive, and, of course, to drop the reference to President Kennedy's assassination.

Mr. Mills said that the main purpose of his remarks would be to raise some heretical doubts on the handling of the transactions in the Open Market Account that the Committee ordinarily conceived to be orthodox and conventional. He then made the following statement:

Confusing developments in the mechanical conduct of Federal Reserve System monetary and credit policy now cause me to concentrate my remarks largely on technical matters. In the short space since the Committee's last meeting, bank credit has recorded a vigorous seasonal expansion, money market conditions, as reflected by Treasury bill yields and the rate on Federal funds, have tended to be relatively easy, and the level of free reserves has plodded along in a narrow rut. It is important to call attention to the stagnancy in the free reserves factor because it belies what has been the feel and tone of a desirably easier money market, and can reasonably give rise to charges that the System's open market operations have practiced a deception on those market observers who lay store on the free reserves level as a guide to its policy intentions.

Granted the forgivable unreliability of our projections of movements in the supply of reserves, the actual setting of the average level of free reserves over a reserve week involves no more than a last-minute arithmetical calculation by the Manager of the System Open Market Account of a desired figure then arrived at by supplying or withdrawing whatever amount of reserves is necessary to make it come out. However, as matters have transpired, reserves movements prior to the arithmetical results of these calculations are what have in reality characterized the tone and color of the reserve week and not the recorded free reserves figure.

Application of this theory to the last two reserve weeks indicates that, in fact, reserves available to the commercial banking system have been adequate to sustain an appropriate expansion of bank credit. At the same time, however, the arbitrary fixing of a level of free reserves can have deceived the financial community. Investor confusion as to the appearances and realities of System policy actions may be a reason for the somewhat slow market response to the more available supply of reserves and the seeming buildup in the supply of Federal funds and in the magnitude of corporate repurchase transactions with U. S. Government securities dealers. That investors should be bewildered about System policy intentions is quite understandable and can be traced to this further step in the direction of artificially controlling a U. S. Government securities market that does not develop an interest rate structure responsive to observable changes in the quantity of reserves and the supply and demand of investment funds. The rising trend in long-term interest rates is presently a better indicator of actual investment conditions than is to be found elsewhere in the area of shorter term securities yields, but here, too, rumor and "official" statements may be influencing interest rate movements beyond the realities of supply and demand considerations.

In the period until the next meeting of the Committee, the market should be allowed a reasonably free rein, and any fortuitous increases in the supply of reserves that exceed seasonal proportions should not be seized upon as an excuse to absorb reserves and to tighten the market.

Mr. Wayne reported that the limited information coming to light in the past two weeks suggested for the most part continued improvement in Fifth District business. Insured unemployment rates were seasonally higher. Contract awards rose almost to record volume in October with substantial strength in each major category. Scattered reports dealing with principal manufacturing industries remained quite favorable. The Cooley one-price cotton bill was passed by the House shortly after the last Committee meeting and was now in the hands of the Senate Agriculture Committee. Bituminous coal production and shipments had remained at high levels. Both cotton and flue-cured tobacco estimates had been revised upward, moderately improving farm income expectations.

Turning to national conditions, Mr. Wayne said that the present period of business expansion had been moderate with several changes of pace, but generally it had avoided excesses. At least partly for that reason it had lived to a respectable middle age. In the short period since the last Committee meeting there had been no major developments to change the moderately favorable outlook. The rise in unemployment was somewhat puzzling and might be slightly disturbing, but a similar rise occurred in November 1962 only to be reversed the following month. Psychologically also, there seemed to be some similarity to the situation of a year ago immediately after the Cuban crisis. The rebound from the tragedy of a month ago, plus some indications that the President was inducing a slightly increased tempo of action by Congress, seemed to have produced, at least temporarily, a somewhat stronger feeling of confidence and optimism in the economy generally. This attitude, together with a record backlog of capital appropriations by corporations, provided a reasonable basis for expecting that business activity would continue at a moderately good level in the weeks immediately ahead.

On the policy side, Mr. Wayne said, there seemed to be no signs of monetary strain or tightness in this period of seasonally intensified activity. In fact, the drop in some short-term rates early last week to their lowest levels since midsummer suggested just the contrary. He realized that this probably resulted from a special combination of circumstances, but even so he believed that Committee policy had been sufficiently easy to take care of seasonal needs and to allow for any sustainable growth or expansion which the economy might generate. The increases in the various categories of reserves and in the money supply in the past two or three months seemed to be ample by any valid measure. Since there had been no significant change in basic conditions or prospects, Mr. Wayne said, it seemed appropriate to continue the Committee's present policy. He would favor renewing the current directive with the elimination of the reference to President Kennedy's death. He did not favor any change in the discount rate at this time.

Mr. Clay commented that it was not likely that the domestic economy had changed in any basic way in the short interval since the Committee last met two weeks ago. It had been a period, however, in which a substantial amount of economic information had become available. The significance of the additional information about the economy's performance and prospects was that it appeared so similar to what it had been for a considerable span of time. Apart from the immediate adjustments in economic activity following President Kennedy's death, the shape of economic events remained largely unchanged, the pace of moderate expansion continued, the problems of needed expansion and underutilization of resources remained, and the evidence of a marked forward thrust in economic activity was still elusive.

Mr. Clay felt that the degree of expansion in the months ahead would depend importantly upon the developments in the cyclically sensitive areas of the economy, one of which was business capital outlays. He observed that much had been said in recent weeks about anticipated business capital outlays, notably following the McGraw-Hill report, and the likelihood of a markedly better performance. This might yet come to pass, Mr. Clay said, but the Commerce-SEC release had been sobering with respect to those expectations. Present evidence seemed to suggest that businessmen do not foresee sufficient market demand for their output to justify a marked rate of expansion in business capital outlays.

Under the circumstances, Mr. Clay continued, monetary policy for domestic purposes should aim to supply reserves in sufficient volume to permit commercial bank credit growth on a seasonally adjusted basis. The goal with respect to the 90-day Treasury bill rate might well remain within the yield range of recent weeks, which presumably would be appropriate for international flow of funds purposes. Over all, these objectives probably would be compatible with the general monetary policy that the Committee had been pursuing. Presently, credit markets would move into the period when seasonal forces might exert downward pressure on short-term rates. It was not possible, Mr. Clay said, to know ahead of time just how intensive those pressures would be in any given year. Moreover, Treasury financing during that period and market knowledge of Treasury and Federal Reserve interest rate objectives might tend to alleviate downward interest rate pressures in those weeks.

If downward rate movement beyond recent levels could not be avoided except by restricting reserve availability on a seasonally adjusted basis, Mr. Clay observed, consideration should be given to accepting a slightly lower level of rates temporarily. The Reserve Bank discount rate should remain unchanged. He would keep the directive as it was except for the elimination of the reference to President Kennedy's death.

Mr. Scanlon said that business sentiment in the Seventh District continued strong, although with cautious undertones. A panel of top executives at a recent annual business outlook session in Chicago had been uniformly optimistic.

The Reserve Bank's recent poll of business and financial economists pointed to moderate economic growth in the next six months with Gross National Product at a rate of about $610 billion in the second quarter of 1964. Many of these observers believed the proposed tax cut was necessary to sustaining expansion beyond midyear.

Local steel experts in Chicago, Mr. Scanlon reported, foresaw a rise in consumption of finished steel from 78.5 million tons in 1963 to somewhat over 81 million tons in 1964 even without inventory building. Imports were expected to be a record 5.5-6 million tons next year. United States ingot production was expected to rise from 109.5 million tons in 1963 to 111 million tons next year. This projection assumed domestic production of 7.5 million autos in 1964, only a slight drop from the 7,650,000 units now expected to be produced in the current year. Auto production and sales continued strong; fourth quarter figures were close to record levels and first quarter projections were being raised.

Consumers appeared to be spending quite freely, Mr. Scanlon said. Additions to savings at commercial banks and savings associations were sharply below the year-ago rate in October and apparently in November as well.

Seventh District banks had not shown as great a rise in loans over the past month as those of the nation. Exclusive of loans to securities dealers, the November rise at District banks was about the same as a year ago. For the second half to date, loan expansion had been 4 per cent, compared with 3-1/2 per cent last year. Borrowing by commercial and industrial firms remained strong, with a large portion of the recent increase attributable to seasonal borrowers and oil company property transactions. Recently demand had been sustained by the usual borrowings related to tax and dividend payments.

The basic position of large Chicago banks had been greatly improved over the past three weeks, Mr. Scanlon continued. Since deposits were down slightly, this development reflected mainly portfolio and dealer loan adjustments.

Turning to policy, Mr. Scanlon said he thought the Committee's posture had been appropriate, but he expected that economic developments in the near future would call for a somewhat firmer money market than was provided in the Committee's current directive. He had the feeling that, in retrospect, it may appear that the Committee should have made such a move now, but with the period of so-called winter lull ahead and possible adverse psychological effects of the current widespread discussion of cutbacks in Government spending, he was inclined to continue the current policy until the next meeting of the Committee. He thought the reference to the death of President Kennedy should be deleted from the directive since any unusual developments in the money market now probably would not be a direct result of that event. He would not change the discount rate at present.

Mr. Deming said that 1963 was closing with Ninth District economic activity continuing to expand, after allowances for seasonal variations. There had been some drop in retail sales late in November but this seemed to have been a reaction to the President's death and the national period of mourning. District bank debits in November were 10 per cent ahead of a year ago. Preliminary estimates for November factory employment seemed favorable. Construction employment had held up better than usual and building permit figures indicated strength in that area. Even the iron ore picture seemed to be better, with shipments in November almost double those of November 1962 and total tonnage so far this year running about 2 million tons or 3-1/2 per cent ahead of last year. Since pellet shipments had increased the iron content shipped this year probably was larger relative to last year than the tonnage figures indicated. The reason for the strong November showing, Mr. Deming said, apparently was a heavier-than-expected drawdown of mill stocks earlier and a desire to rebuild them, which might augur well for steel output this winter.

Fourth quarter cash farm income in the Ninth District apparently would be off sharply from the same period a year earlier, Mr. Deming reported. This would pull cash income for 1963 below 1962 but not by much, perhaps 1-1/2 per cent. The fourth quarter drop seemed to reflect some holdup on marketings of both grain and livestock, perhaps partly reflecting tax considerations. Thus, the prospect now was for a more favorable first quarter farm income picture than had been expected earlier.

Mr. Deming said the Federal Reserve Bank of Minneapolis had inaugurated a new sample of some 15 to 20 big manufacturers headquartered in the Ninth District but operating nationally and, in most instances, internationally. They were asked for information on current operations both within and without the District and about prospects for their firms for the coming quarter. The survey was too new to lean on heavily as yet, but four points brought out seemed worthy of note. First, current (November) figures on new orders, order backlogs, inventories, and employment indicated mostly stability to growth relative to October. Any declines seemed to be seasonal or due to unusual circumstances. Second, the out-of-District figures seemed to be more favorable than the in-District figures, which might also reflect seasonal factors. Third, expectations for the first quarter of 1964 in terms of output, employment, and profits were favorable; in fact, more favorable than current developments were relative to those of the immediate past. Fourth, average prices for finished products apparently showed no change in November and most respondents expected no change in the first quarter of 1964. Of the three firms which expected price changes, two expected prices to rise slightly and one expected its prices to fall slightly.

Turning to banking, Mr. Deming said that the statistics indicated a much stronger than normal credit expansion in November, with loans sparking the expansion, but a return to normal seasonal changes in the first two weeks of December. Deposit growth, which was larger than usual in November, apparently had carried over its strength into December. Ninth District banks did not seem to be under any particular pressure but, particularly at city banks, loan-deposit ratios had moved up rather sharply recently, although they were still 3 or 4 points below their previous peaks.

With respect to policy, Mr. Deming said he agreed with those who suggested there should be no basic change over the next three weeks. As he looked at the figures in the Board staff's memorandum on reserves, he was struck by the fact that borrowings and free reserves in October, November, and December were fairly stable, if one averaged the weekly figures shown for each month. This, he thought, was about the policy posture the Committee should be taking. He would expect an upsurge in borrowings in December, and consequently lower free reserve figures. He would not be disturbed if free reserves fell below $100 million--a level somewhere around $50 million seemed all right--although he did not advocate operations to push free reserves down. Mr. Deming concluded by noting that Treasury financing operations planned for January and February might put some pressure on the market and in a sense serve as a substitute for any additional pressure by the System. He would not change the directive except to delete the reference to the President's death.

Mr. Swan reported that activity in the Twelfth District seemed to be continuing at a reasonably satisfactory level. In California employment increased slightly in November but, as in the country as a whole, there were substantial additions to the labor force and consequently the unemployment rate rose rather sharply.

Mr. Swan said he was glad to see that Mr. Brill had slightly qualified his reference to the universal degree of optimism. He (Mr. Swan) happened to be in Seattle when cancellation of the Dyna Soar project was announced. The reaction there had been remarkably widespread and sharp. The cancellation means that 5,000 workers engaged on that project will be affected, and this follows a decline of about 14,000 jobs from the peak in 1962 in the aircraft industry in the State of Washington. There was a general feeling that these job reductions would have some secondary repercussions on the economy of the area, but it was too early to determine what the effects would be.

Attitudes were quite different in the Spokane area, Mr. Swan said. Conditions in agriculture, in lead, zinc, and silver mining, and even in the lumber industry provided a basis for some optimism.

Mr. Swan reported that there had been no marked change in the Twelfth District's financial picture during the past two weeks. Weekly reporting banks had shown a substantial increase in loans, although not so much as in the nation as a whole. District banks were net sellers of Federal Funds in the first two weeks of December but they expected to be net purchasers in the current week.

Turning to policy, Mr. Swan said that in view of the somewhat more moderate increase in economic activity recently, the rise in the unemployment rate in November--which he found difficult to interpret--and the substantial cross-currents in the money market that probably would continue for a time, he saw no basis for changing policy at present, not even to move to a slightly lesser degree of ease. It seemed to him that in light of these factors and of the expected reversal of seasonal pressures it would be better to wait and see what happened through the year-end before making any decision on a policy move. He would like to see the bill rate fluctuating around the discount rate, presumably with free reserves in the area of $50 to $100 million. He would not change the discount rate, nor would he change the directive except to delete the reference to the President's death.

Mr. Irons reported that attitudes in the Southwest were quite optimistic. There were a few scattered indications of further expansion, but on the whole the available data were neither current enough nor good enough to support these attitudes. Scattered comments from merchants in the District indicated that they expected Christmas business to be up, with some expecting a moderate increase and others a substantial one. The various elements in the economic picture were about as he had reported them at the last few meetings. Activity was at a high level and inching up, and a more substantial rate of increase was expected.

On the banking side, Mr. Irons said, there was more evidence of expansion. Loans were up more than seasonally at District banks, with substantial gains in commercial and industrial loans and consumer loans. The press in the District seemed to be urging people to use consumer credit and some recent articles in the business sections of Dallas papers amounted almost to exhortations on the subject. Bank holdings of Treasury bills had risen, and bank investments generally were up substantially in this short period. Demand and time deposits also had risen. A few banks had been heavy purchasers of Federal funds, and a few banks had been relatively heavy borrowers from the Reserve Bank. A fairly substantial increase in borrowings between now and the end of the year seemed likely.

Mr. Irons noted that recently there had been a flurry of interest on the part of some District banks in the possible use of capital debentures; also, a large bank had announced that it would issue mortgage notes on its buildings and use the funds to better meet its customers' credit needs.

With respect to policy, Mr. Irons said, he came out today at the same place as many others; he would hold to present policy and not attempt to establish a situation of either less ease or more ease. He thought the Committee should continue to watch price developments closely, but he agreed with some of the comments that Mr. Mitchell had made regarding price indexes. He was particularly distrustful of the consumer price index as a reflector of the cost of commodities. At the moment, he did not feel there was a strong inflationary bias in the economy, although one might develop, and he would not advance such a bias as a reason for changing policy. Mr. Irons thought the present situation, with the bill rate around 3.50 per cent and the Federal funds rate at 3.50 per cent, was about right. He advocated continuing to make reserves available as needed. He favored maintaining the status quo, more or less, until the year-end, meanwhile observing developments. He would not change the directive other than to eliminate the reference to President Kennedy's death.

Mr. Ellis said First District department store figures suggested that Christmas season sales this year would probably exceed those last year despite the shorter shopping period. Regional statistics suggested that the underlying tendency of the District economy was in the direction of continued upward thrust, with developments in construction, production, nonmanufacturing activity, and vacation business the most outstanding. At banks, October and November brought demand deposit totals to a level some 6 per cent ahead of last year. District banks had moved sharply from net buyers of Federal funds in September to net sellers since. These influences had brought to an end the contraction in bank holdings of short-term Governments and had halted the year-long rise in loan-deposit ratios. They also interrupted the decline in short-term liquid asset ratios that began in the first quarter of 1963.

Turning to monetary policy, Mr. Ellis said that several aspects of the current situation inclined him in the direction of restraint. For example, he said, the standard analysis suggested a strongly expanding economy in its 34th month of expansion and facing another year of substantial growth. The economy was likely to be impelled forward by a tax reduction effective January 1. Except for concern with the 5-1/2 per cent rate of unemployment, people would be describing the economic situation in glowing terms. It seemed to him that higher minimum wages and liberalized unemployment compensation provisions, coupled with changed attitudes toward "acceptable work," inevitably meant a higher rate of unemployment in the economy, and experience did not suggest that this problem could be solved by credit injections.

Since the Committee's last shift in monetary policy in July, Mr. Ellis continued, reserve expansion had materially exceeded the staff guidelines, to the point where the rate of credit expansion might well be considered to be unsustainable. Since July reserve expansion had been at an annual rate of 6 per cent, while the money supply had increased at a seasonally adjusted annual rate of 5 per cent. At some point the burden of proof must shift to those who wanted to continue inflating the money supply at the current rate. Considering international capital flows, he thought it appropriate to note that foreign lending at First District reporting banks stood 41 per cent above the year ago level, with all of the gain occurring since July. Fourth quarter balance of payments figures when published would not be well received, and questions might be raised about the use of monetary policy in light of these figures. Belgium, France, and Canada had all recently increased their bank rates by 1/2 per cent, Mr. Ellis noted, and Sweden and Switzerland had permitted a rise in market rates. The Committee had been told this morning about the attractive rates prevailing in Germany.

These various developments, Mr. Ellis said, suggested to him that the next move in monetary policy should be a gradual shift to what he would label as a neutral position. He had the feeling that the Committee had already crossed the threshold for policy that Mr. Holland had mentioned. He was troubled by the fact that the opportunities for changing policy in the near future were slim in view of the Treasury financing calendar; the choice seemed to be to change policy now or wait until spring. He thought that now was the time to move toward neutrality, Mr. Ellis continued, and as targets he suggested a gradual lowering of free reserves to zero by mid-January and acceptance of short-term rates up to 3.60 per cent with occasional fluctuations above that level. He would amend the directive accordingly. In mentioning these targets, Mr. Ellis said, he was aware of the problems that faced the Desk during the next few weeks; it was going to take a great deal of running even to stay in one place.

In a concluding remark, Mr. Ellis said he accepted the possibility that developments in the market might make discount rate action desirable before the mid-February Treasury refunding.

Chairman Martin noted that barring an unforeseen event this would be the last Committee meeting of 1963. He thought the Committee was closer together in its views this morning than it had been for some time.

He recently had re-read the minutes of the meetings for the last year, the Chairman continued, and he was inclined to think that the Committee, on looking back over what had been a difficult year, would feel that monetary policy had done well. In his opinion the timing of policy actions had been good. The Committee had been right when it moved to slightly less ease at this time last year. The most dramatic policy action had been the discount rate change in the summer of this year. While judgments might differ, he believed it had been almost essential to take that action then in view of the balance of payments situation that was developing. No one would know how much effect the discount rate change had had on the balance of payments because the interest equalization tax proposal came into the picture almost immediately, but in his judgment the effect was salutary.

Chairman Martin said he would be inclined to Mr. Scanlon's line of reasoning if the Committee were to attempt to project into the future, but he did not think the Committee should do so. He favored no change in policy at the present time for a variety of reasons. He thought that the economy was in a period of excessive optimism, and such optimism disturbed him because he did not think it was warranted by the facts. To some extent the optimism was the result of efforts to pass the tax program; there had been a psychological buildup about what could be achieved by a tax cut that was disproportionate to the likely consequences. Some kind of tax program probably would be passed in late February or early March and made retroactive to the first of the year, but its actual impact on the economy remained to be seen.

If the Committee made no change in policy today, Chairman Martin continued, it would be pretty well blocked out for a long time. This was not a case of holding off until the next meeting; the changes were that the next opportunity for action would not occur before March. If the present euphoria should be translated by a tax cut into a real surge in the economy, the System might be faced with the need for a change in the discount rate or some other drastic action to be taken at the first opportunity. This was something the Committee should not lose sight of.

The whole western world was again faced with the specter of inflation, the Chairman observed, and he was opposed to inflation because it led to deflation. There were those who believed that unemployment could be cured by easy money. He doubted this; monetary policy had a residual influence on the unemployment problem, but budget, fiscal, and wage-price policies had more fundamental effects.

What the Committee was faced with, the Chairman commented, was a condition of euphoria that was pushing interest rates higher than justified by underlying supply and demand conditions in the markets for funds. He believed that even with the expected return flow of funds this situation was likely to continue into the first part of the year. He agreed with Mr. Shepardson's comment that the Committee should not let the situation get away from it on either side. Monetary policy had been reasonably successful in assisting the domestic economy without inflation over the past year, and should continue to try to help the economy in every way it could. At the same time, it was necessary to be cognizant of the balance of payments problem. He did not anticipate a run on the dollar, but the Committee must keep alert.

In sum, the Chairman said, monetary policy had had a good year, and he thought it inadvisable for the Committee now to force its hand. A tax reduction probably was not too far off. If for any reason, however, the tax cut should be set back there would be deterrent effects on the economy, but the Committee probably would have time to face up to this eventuality if it occurred. He thought the Committee was justified at this juncture in accepting the good fortune it had had with monetary policy to date. He favored continuing the directive as it stood except for the elimination of the reference to President Kennedy's death.

In further remarks Chairman Martin said the Committee should do everything in its power to assess the role of monetary policy in the early part of the new year. He thought the Committee could take a certain amount of satisfaction from developments in 1963, but the real test would come if a tax reduction was voted. With respect to the price situation, he did not believe that monetary policy could control prices, but it was one factor affecting them. He did believe that prices were on the move and the Committee could not afford to be complacent. While the wholesale price index continued to hold to its earlier level, the desire and the tendency to raise prices was quite evident in business today. The Committee had to recognize that the price problem was going to remain with it. The Committee could not ignore it and should try to reassess it.

Chairman Martin said he thought the large majority of members were for no change in policy today, and for no change in the directive except the deletion of the reference to President Kennedy. He would hope that at some point early in the new year the Committee would have enough information to make a more fundamental judgment on policy, but in his opinion it did not have that information today.

> 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 Federal Open Market Committee's current policy to accommodate moderate growth in bank credit, while maintaining conditions in the money market that would contribute to continued improvement in the capital account of the U.S. balance of payments. This policy takes into consideration the fact that domestic economic activity is expanding further, although with a margin of underutilized resources; and the fact that the balance-of-payments position is still adverse despite a tendency to reduced deficits. It also recognizes the increases in bank credit, money supply, and the reserve base of recent months.

To implement this policy, System open market operations shall be conducted with a view to maintaining about the same conditions in the money market as have prevailed in recent weeks, while accommodating moderate expansion in aggregate bank reserves.

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

Mr. Mills said he did not object to the deletion from the directive of the reference to the President's death, but he dissented from the decision to make no change in policy for reasons that he had cited previously. He observed that the actual experience of the last two weeks with respect to availability of reserves fitted his own judgment of a viable and constructive credit policy but in his opinion it did not conform to the language of the directive. There would be a relatively short period from now until the next meeting during which there might be some temporary seasonal tightness. However, such a development appeared unlikely since the weight of events seemed to be toward ease; the projected movements in reserves, the customary early-year tendency towards credit liquidation, and the post-Christmas return flow of currency all tended in this direction. He did not understand why the Committee should be so concerned about inflation as to wish to accelerate a normal seasonal credit contraction and to produce a lower level of free reserves and credit availability. He could not reconcile this with the kind of credit and monetary policy that in his judgment it was the responsibility of the Committee to formulate. Over the years and particularly this year, Mr. Mills continued, he had become increasingly of the opinion that monetary policy could do a great deal more harm than good. He thought it was the tendency of the Committee to permit its fears and concerns to lead to the harmful side of contraction.

Mr. Hayes said he favored deleting the reference to the death of President Kennedy but he dissented from both the directive and the consensus for no change in policy. In his judgment the Chairman had been quite realistic about the matter of timing; if no change in policy was made at this meeting the Committee would be precluded from making a change for about three months, and to his mind this was unwise. Mr. Ellis had put the case for a slight move toward less ease very ably. Mr. Hayes said he had the feeling that many people around the table saw inexorable forces leading the Committee to less ease and he was at a loss as to why the Committee should not make a modest step now to pave the way. He had hoped for action at this meeting similar to the action taken last December; it seemed as appropriate now as it had then.

In response to a question from the Chairman, Mr. Stone said he did not consider it necessary to recommend any amendment to the continuing authority directive with respect to the limit on the change in the aggregate amount of U.S. Government securities held in the System Open Market Account during any period between meetings of the Committee.

It was agreed that the next meeting of the Federal Open Market Committee would be held on January 7, 1964.

Thereupon the meeting adjourned.

Assistant Secretary