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, January 28, 1964, at 9:30 a.m.

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

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

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

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

Mr. Molony, Assistant to the Board of Governors
Mr. 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. Axilrod, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, Secretary, Office of the Secretary, Board of Governors

Messrs. Thompson and Coldwell, First Vice Presidents of the Federal Reserve Banks of Cleveland and Dallas, respectively
Messrs. Willis, Mann, Ratchford, Taylor, Jones, Parsons, and Grove, Vice Presidents of the Federal Reserve Banks of Boston, Cleveland, Richmond, Atlanta, St. Louis, Minneapolis, and San Francisco, respectively
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 December 17, 1963, and January 7, 1964, were approved.

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 January 7 through January 22, 1964, together with a supplemental report covering the period January 23 through January 27, 1964. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Coombs stated that the Treasury gold stock probably would remain unchanged this week for the fourth week in a row. The Treasury still had on hand in the Stabilization Fund nearly $30 million, which might be supplemented by another $20 million or so from a Gold Pool distribution at the end of the month. On the other hand, there were already in sight orders for $45 million of gold in February and, unless the Russians became heavy sellers once

more, the Treasury might be forced to show a reduction in the gold stock during the course of the next month.

Mr. Coombs reported that the foreign exchange markets had been fairly active during the past three weeks, with a potentially troublesome situation developing in the German mark. The German trade surplus had strengthened considerably during the past six months or so and consequent buying pressure on the German mark had been reinforced by sizable flows of long-term money into the German bond market, where rates approaching 6 per cent were still available. In addition, there had been a revival of speculation on a further revaluation of the German mark and this apparently had contributed to some short-term inflow in recent weeks. Since January 17, the German Federal Bank had taken in $121 million but had felt it appropriate to hold the entire amount for their own account rather than suggesting that the System draw upon the swap to mop up part of the dollar inflow. So far, about all the German authorities had done to deal with their balance of payments surplus was to try to get the long-term interest rate down from 6 to 5-1/2 per cent and to take steps to give Germans preference over foreign investors in the market for new bond issues.

Unless the German Government put together a program designed to deal effectively with their surplus, Mr. Coombs thought there might be a sudden burst of speculation in this market. He was hopeful that the Account would be able to conserve its resources under the swap line to deal with such an eventuality.

The Swiss franc market also had been disturbed by rumors of revaluation during recent weeks, Mr. Coombs said, and the Account Management had suggested a resumption of Treasury forward operations to provide official reassurance. Buying pressure on the Swiss franc had eased off after forward sales of no more than $9 million and, yesterday, the Swiss Government announced a comprehensive program to restrain domestic inflationary trends while at the same time establishing new barriers to inflows of speculative funds from abroad. This program, which had been submitted to the Swiss Parliament, would require the commercial banks to maintain reserves with the Swiss National Bank equal to 100 per cent of all foreign deposits received since the first of this year, unless the banks invested in foreign markets an amount equivalent to such new deposits. The commercial banks, together with other financial intermediaries, would also be prohibited from employing foreign funds to purchase Swiss property in any form. Finally, the banks would become subject to specific limits on their outstanding loans. Such restraint upon commercial bank lending would be reinforced by similar close controls of new issues of stocks and bonds on the Swiss market. The management of the Swiss National Bank expected that these measures would not result, at least for the time being, in a tightening of the Swiss money and credit markets or an increase in interest rates. On the other hand, if the action proposed to restrain the influx of foreign money should prove effective, the consequent emergence of a

basic deficit in the Swiss balance of payments would, in due course, contract liquidity and presumably put some pressure on interest rates.

Mr. Coombs said he had the impression that the government's proposals might be strenuously resisted by the commercial banks and Swiss industry, and the parliamentary outcome of the program remained somewhat uncertain. The initial reaction in the exchange markets, however, had been a strengthening of the dollar.

Mr. Coombs reported that the Netherlands guilder had weakened appreciably during the past week, partly reflecting, according to Dutch financial officials, some movement of long-term money into the German market. The Netherlands Bank had been supplying dollars to cushion the decline in the guilder rate and so the Account had been able to acquire $22 million of guilders in direct transactions with the Netherlands Bank, of which $20 million had been used to pay down the swap drawing from $70 million to $50 million and $2 million had been used to strengthen the System's cash position in guilders.

The Italian lira remained under heavy pressure, Mr. Coombs continued, and the Bank of Italy had been forced to supply roughly $150 million to the market during the first three weeks of this month. According to Italian financial officials, the main source of this pressure seemed to be repayments by Italian commercial banks of earlier borrowing from abroad. This would suggest that the remaining elements in their balance of payments were improving. In order to avoid showing

an unduly sharp decline in Italian reserves during January, the Bank of Italy had requested a second drawing of $50 million on the swap line, as well as Treasury purchase of an additional $50 million of lire in anticipation of the maturities of the Treasury's lira bonds outstanding. The purchase of lire against the Treasury's bond indebtedness was made by the System with immediate forward sale of the lire to the U. S. Treasury. This increased the System's purchases of lire for forward sale to the Treasury to $100 million, or the full amount of the authorization previously approved by the Committee.

Finally, Mr. Coombs said, the usual seasonal inflow of dollars to the Bank of England did not seem to be materializing this year. This might suggest that speculative pressures on sterling expected in connection with the forthcoming election were already beginning to appear.

Mr. Deming inquired whether it was likely that the Italian authorities would reduce the rate at which they were supporting the lira, and whether anything would be gained if they brought the support level down to par.

Mr. Coombs said that he had raised the question of the support level with the Italian officials. It was their feeling that a decline in the rate within the range of established limits would be too small to have much strengthening effect on exports. Moreover, they thought a decline in the exchange rate would be interpreted by the market as a signal of weakness, and this would add to their difficulties instead of

relieving them. He had not pressed the point with the Italians, who were on the spot and knew what they were up against.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period January 7 through January 27, 1964, were approved, ratified, and confirmed.

Mr. Coombs stated that he had no recommendations to place before the Committee for consideration at this meeting.

Chairman Martin noted that Messrs. Hayes and Coombs had recently returned from a meeting of the Bank for International Settlements at Basle, and he invited Mr. Hayes to comment.

Mr. Hayes said the discussions on Sunday afternoon, January 12, had been devoted to the Euro-dollar market and to the study being made by the Group of 10 meeting in Paris. The discussion of the Euro-dollar market was based on the experts' study of a few months ago. As often was the case, this discussion was not conclusive; positive conclusions were hard to come by because of the great many unknown factors. There was some disposition to collect more statistics, although there was a reluctance to bother commercial banks too much by asking for a lot of detail.

There was a general feeling of unease about the Euro-dollar market, Mr. Hayes said, but no full consensus on what should be done about it. Several of those participating in the meeting cited

objections to direct borrowing by domestic firms from foreign lenders, because it put borrowing out of the control of the central banks. With respect to the Euro-dollar market in general, although the first use of the funds might be prudent and conservative, there was doubt as to the nature of the use at succeeding steps. The British authorities did not seem much concerned about this situation; they evidently felt that the London banks placed their funds with conservative banks abroad. Several of the participants agreed that central banks should not be in the Euro-dollar market, and there had been some tendency for central banks to pull out. There was some discussion as to whether the Euro-dollar market was the problem or whether the administration of international credit in general was getting too loose. Some feeling was expressed, notably by the Canadians, against any sharp dampening down of the market. The conclusion was that this subject should be discussed further.

He had been asked for his views on the study being made by the Group of 10, Mr. Hayes continued, and he had agreed to give his personal views, noting that the System had no direct responsibility for the study. He had expressed the hope that the study would not raise doubts about the soundness of the present system; if it did so, the study might end up by impairing international liquidity rather than by finding ways to increase it. He had questioned the practicability of the plans for multiple reserve currencies, such as the

Bernstein plan, but he had the feeling that this type of scheme had made some headway among the group. There was some support for the view that the real problem now was the United States balance of payments; and some saw a multiple reserve currency scheme as a means for making the Europeans less dependent on what happened in the United States. This had been discussed one evening, and the point had been raised that the U. S. itself had asked for the study, implying that we must feel that the present system was not adequate. Thus, we should not be surprised if some rather radical proposals were being pursued.

Mr. Hayes felt that the participants' concern over their own domestic problems tended to divert their attention from the problem of the U. S. payments deficit; some were so concerned about internal inflation that they were spending little time on the problems of the U. S. Nevertheless, there was considerable uneasiness over our payments situation. They had been pleasantly surprised by the U. S. payments figures for the fourth quarter, but questions had been raised as to whether the improvement would continue. One central banker, from one of the largest dollar-holding countries, had put great emphasis on the need for the U. S. to hold the line on wage costs. Another had expressed the view that the U. S. was exporting inflation by an excessively easy credit policy. He had argued that the American unemployment problem was structural, and should not be attacked by

monetary policy. He believed the lack of inflation in the U. S. was a consequence of our payments deficit--a proposition which Mr. Hayes thought highly dubious. In conclusion, Mr. Hayes noted that while the participants were still willing to give the dollar the benefit of the doubt, there was an underlying uneasiness as to whether or not the U. S. really had come to grips with its problem.

Before this meeting there had been distributed to the members of the Committee 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 January 7 through January 22, 1964, together with a supplemental report covering the period January 23 through January 27, 1964. Copies of these reports have been placed in the files of the Committee.

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

> As customarily happens during January, the System absorbed a large volume of reserves in the past three weeks, offsetting the provision of funds through the seasonal return flow of currency and the decline in required reserves. Float came down more slowly than usual, in good part because of heavy snow storms, and inflated the reserve figures for a time around the middle of the period. Federal funds nevertheless traded mainly at 3-1/2 per cent and on most days traded exclusively at that rate. On the other hand, and probably reflecting the relatively high level of float, there was seldom any large margin of unsatisfied demand for reserves to be met at the discount window, so that member bank borrowings were generally somewhat lower than in other recent periods.

In the Treasury bond market attention was focused on new financing operations during the recent period. The advance refunding of six short-term maturities into reopened issues maturing in 1970 and 1975-85, which the Treasury announced just a day after the last meeting of the Committee, was initially greeted with some coolness as well as surprise by the market. By the time the subscription books for the exchange had closed on January 17, however, the market was developing a greater interest in the Treasury offering--particularly in the 4-1/4 per cent bonds. One factor tending to strengthen the market at that time was the stream of news from Washington pointing to budget economies and smaller deficits than had been anticipated earlier. The response to the 4-1/4 per cent issue, including a subscription from Treasury investment accounts, was such that the Treasury allotted 83-1/2 per cent on large subscriptions in order to hold the total down to the $750 million initially offered. The response to the 4's remained moderate, however, with total subscriptions reaching about $2-1/4 billion out of the $4 billion limit specified by the Treasury. This relatively modest response seemed to be not so much a matter of unattractive pricing but rather a limited appetite for extension--particularly from commercial banks, which were the principal holders of rights. We heard time and again during the refunding that a great many banks would choose to hold their short Governments as liquidity reserves against expected further growth in loan demand over the months ahead. Some market observers have drawn the inference from this that the Treasury might find only limited interest in an offering beyond the relatively short-term area in the forthcoming February refunding, the terms of which are scheduled to be announced on Thursday. However that may be, the Treasury did achieve a respectable amount of debt extension through its advance refunding.

The Treasury bill market has enjoyed a period of good demand in recent weeks, with buying particularly brisk during the advance refunding as sellers of rights reinvested in bills. In yesterday's bill auction the average issuing rates for the 3- and 6-month bills were about 3.50 and 3.61 per cent--down about 4 and 6 basis points, respectively, from the rates three weeks ago. While this was not a very sharp move it did represent a little greater degree of fluctuation in rates than had prevailed for several weeks, and from a technical point of view was very helpful to the market.

Other segments of the capital market also enjoyed a favorable atmosphere in the recent period as January reinvestment demand proved strong. In the corporate market this demand encountered a limited supply of new offerings. In the municipal sector there was a sizable volume of offerings, but these new issues were generally very well received. The good performance of the corporate and municipal markets, I should mention, provided a helpful backdrop to the Treasury's advance refunding operation.

Finally, the bankers' acceptance market also experienced good demand after rates were increased by 1/8 per cent on January 14. This rate increase, which the dealers put into effect after total inventories reached a record $380 million, elicited sufficient demand to reduce dealer holdings to $240 million by last night.

Following this statement, Mr. Stone indicated that he did not recommend a change at this time in the leeway on change in System Account holdings between Committee meetings, which had been increased to $1.5 billion at the preceding meeting of the Committee. In his judgment, the previous limit of $1 billion might prove too low during the period until the next meeting.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period January 7 through January 27, 1964, were approved, ratified, and confirmed.

The staff economic and financial review at this meeting was in the form of a visual-auditory presentation, for which Messrs. Garfield, Hersey, and Partee of the Board's staff joined the meeting. Copies of the text of the presentation and of the accompanying charts have been placed in the files of the Committee.

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

> Policy decisions have their impact on the future, and that is where economic analysis must focus. To the extent the future can be scheduled, it looks to be an eventful year ahead. A surprising January Budget seems likely to be followed, in the next month or so, by a substantial tax cut. In March we shall have a key report on business spending plans for plant and equipment. In April or May, the new GATT trade negotiations will formally begin. In June, the number graduating from high school will be larger than ever before by a considerable margin.
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> Events of the summer will include the nominating conventions and wage negotiations in the auto and nonferrous metals industries. By late autumn, elections in the United States and the United Kingdom will be over.
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> Policy makers will have to face each of these events in turn, assessing their likely impact in light of then prevailing economic conditions. Today, our staff analysis will focus on the economic situation on the eve of the second key event of 1964--a major revision of our tax structure. What is the economic climate in which we await this long-delayed overhaul of our Federal revenue system? What is the momentum of the economy that the tax cut is expected to accelerate?
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> How balanced is the economy's progress, in terms of avoiding shortfalls in utilization of resources on one hand and speculative excesses on the other? Are wage and price pressures dormant, or have they already set in train the sequence of cost-price push that contributed to curtailment of earlier postwar expansions? Are we out of the woods in respect to international trade and capital flows? Are current monetary and credit conditions conducive to sustained expansion in economic activity?
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> Our aim this morning is to assemble what evidence is available to facilitate answering such questions. We start with Mr. Hersey's report on the balance of payments situation, which in recent years has been of critical importance in policy formation.

There followed sections dealing with the U. S. balance of payments, domestic business developments, and domestic financial developments.

The concluding portion of the review, presented by Mr. Koch, was as follows:

Our presentation this morning has focused on the key economic and financial developments at home and abroad that have to be evaluated before arriving at a judgment regarding the most appropriate posture of monetary policy. On the domestic front, over-all economic activity continues to increase. Industrial production seems to have hung at about the level reached six months ago, but the trade, service, construction, and State and local government areas continue strong. Prices are firming, particularly for some metals, but not all announced increases hold, and there are some less-publicized declines which are keeping the over-all indexes stable. Businessmen's announced spending plans suggest quiet confidence, rather than exuberance, and substantial unused resources still characterize the economy.

Bank credit, deposit, and reserve expansion continue fairly rapid, but the growth in total credit flows can be characterized as moderate and orderly--in keeping with the expansion in real output. In the light of the margins of unutilized resources that remain, the expansion thus far seems, on the whole, constructive rather than excessive. All this is not to deny that some aspects of the economy warrant constant watch, particularly price and wage developments, inventory buying, the stock market, the construction and financing of income-producing properties, and the over-all rate and quality of credit expansion.

On the international side, there is at least a possibility that coming months will see a deficit in the balance of payments little if any higher than in the last half of 1963. Outflows of liquid funds and of bank credit could again pose a threat, particularly if additional leading foreign countries adopt more restrictive monetary policies with resultant higher interest rates as part of programs for coping with their domestic inflations. At the moment, however, international money market differentials are not such as to trigger substantial shifting of liquid funds.

Looking ahead, the stimulative effects of the tax cut on the economy in the first half of 1964 are projected as very large, with the Federal deficit on an annual rate, income and product basis estimated to jump from about $2 billion in the fourth quarter of 1963 to about $10 billion in the second quarter of 1964. Whether this will prove too

much stimulation either immediately or after a time lag remains to be seen.

Until the effects of the tax cut are more apparent and measurable, and so long as the economy maintains its moderate upward pace with price stability and with an improved balance of payments situation, the current, moderately expansionary monetary policy remains appropriate. Special attention will need to be paid, though, to the economic situation as it unfolds over the next few months lest a combined stimulative fiscal and monetary policy facilitate such an upsurge in private spending and investing that inflationary developments ensue or a large payments deficit re-emerges.

In the discussion following the visual-auditory presentation, Mr. Ellis noted that an article in this morning's Wall Street Journal had reported that an index of industrial raw material prices had risen by 5 points in the past 5 months, and that this was the largest increase for any period of comparable length since 1961. He had not seen a report on this index in the presentation, and he asked whether it was a special subcategory of the broader wholesale price index that had been presented.

Mr. Garfield replied that a great many special-purpose indexes had been developed from components of the broader measures in recent years. The behavior of these indexes varied, depending on such factors as the importance attached to commodities such as sugar, the price of which had moved very far, and the importance attached to prices in American relative to foreign markets. One could put together many different combinations of price series that would show markedly different change over particular periods. The broader measures had been used in today's presentation.

Mr. Mills asked whether there was not some element of illusion in the emphasis that was placed on the degree of liquidity in the economy, in that the liquidity measures that were generally advanced had to do with holdings by the public of the liabilities of financial intermediaries, and the fact that the intermediaries proposed that their clients could consider these liabilities as readily liquid assets. Was it not necessary, he inquired, to look behind the facade of transferability and marketability of these liabilities to the nature of the underlying assets supporting them. To a substantial degree in the recent past, the growth in the liabilities of intermediaries had been associated with accumulations by them of mortgage holdings. Mortgages themselves were not of a particularly liquid nature, Mr. Mills said. Perhaps the growth of mortgage holdings in the past several years had substituted for the kinds of securities the corporate sector would have issued except for the fact that their large flows of internal funds had obviated the necessity for their use. There was a question whether one might not have a false sense of security about the state of liquidity in the economy, because the underlying assets were not liquid, and the liquidity of the intermediaries' liabilities depended on the whims of the public as to their marketability.

Mr. Partee said that he would make two comments in response to Mr. Mills' question. First, the liquidity measure used in the

presentation was defined to include deposits at commercial banks and mutual savings banks, share-holdings at savings and loan associations, and Government securities holdings with maturities under one year. The holders of those assets certainly thought that they had liquid assets, but in fact there was no legal obligation on the part of, say, savings and loan associations to pay on demand. It was customary, of course, for them to pay on demand, and there would be a very substantial shock to the economy if they stopped doing so. Also, the Home Loan Bank Board did stand ready to provide emergency liquidity to the associations, just as the Federal Reserve did with respect to member banks. He thought it was reasonable to consider savings and loan shares as liquid in normal circumstances, although he did not mean to discount the point Mr. Mills had made with respect to the nature of the intermediaries' assets.

Secondly, Mr. Partee continued there was some tendency to overstate the rise in liquidity that had occurred in the last three years, to the extent that a shift had occurred from direct investment to saving through intermediaries. The typical holder of corporate bonds, stocks, or municipals probably felt these direct investments had some liquidity, although they were excluded from the liquid asset series. Liquidity obviously was a continuum, and it was difficult to measure.

Mr. Balderston said that he suspected that much of the apparent balance of payments gain in the last half of 1963 was due to anticipation

of the interest equalization tax. He wondered whether the realization thereof would be as potent in deterring capital outflows as the anticipation had been. If it was not, he asked, were the expectations with regard to a continued low payments deficit in the first part of 1964 apt to be disappointed?

Mr. Hersey said that the estimate of a continuation of the recently reduced rate of deficit did not depend to any great extent on the equalization tax. Part of the improvement in the payments balance during 1963 was in the trade and services accounts. With the present growth of trade, this seemed likely to persist and possibly to improve further in the short run. However, the estimate for 1964 did assume that new foreign borrowings would not approach the abnormally high levels of the first half of 1963, when Canadian security issues in the U. S. had been exceptionally large.

Mr. Mitchell asked whether it would be fair to say that the surplus countries were beginning to take their obligations with respect to achieving a balanced position more seriously. Mr. Coombs commented that the Swiss certainly were doing so. Also, French reserve gains had leveled off in part because of governmental measures to restrain capital inflows and domestic inflation--although these actions were not redounding mainly to our benefit, but rather to Germany's. The Germans recognized their responsibilities, but there seemed to be a large gap in their case between recognition and action.

Their surplus position reflected primarily their competitive power and their greater success than some other countries in controlling domestic inflation. In the circumstances there were only a limited number of steps they could take to move towards a balanced position, none of which was pleasant.

At this point Messrs. Garfield, Hersey, and Partee left the meeting.

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

> Both the year and the quarter ended on a strong note. The year's gain in GNP was better than had been estimated a few weeks ago and of course far above standard forecasts of a year ago. December contributed importantly to these good results, as retail sales jumped sharply to a new record and industrial production advanced moderately--both contrasting with the hesitancy shown a year earlier. Business sentiment also appears to be much stronger than in early 1963, and the prospects for a near-term tax reduction are now of course very much brighter. All in all, the Council of Economic Advisers' projection of a 1964 GNP of about $623 billion, some 6.5 per cent above 1963, seems rather reasonable, even though there may be a relatively sluggish first quarter attributable in part to a temporary leveling off of plant and equipment outlays. The CEA estimates that even this sizable gain in GNP will pull unemployment down only to about 5.0 per cent by the end of 1964--and this highlights the necessity of attacking the unemployment problem through other measures besides the stimulation of over-all demand.
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> Recent wholesale price developments point to the need for a close watch on this area, as was re-emphasized in the President's Economic Report. The index of industrial

wholesale prices has risen over the past eight months at an annual rate of about 1-1/4 per cent, which compares closely with the rates of increase at the beginning of the last two business cycle expansions and might be the forerunner of more rapid price increases, although it is certainly too early to reach any definite conclusion on this.

We have been studying the possible economic implications of the new Federal budget. On balance, it looks as if the combination of a tax cut with restraint on the spending side will provide less of a stimulus over the next eighteen months than seemed probable a few months ago. On the other hand, the favorable psychological and incentive impact of the tax cut could be very considerable. From the standpoint of Treasury financing, the 1965 budget seems to offer no serious problems.

As for the balance of payments, we can find satisfaction in the heavy surplus recorded in December, while still reserving judgment as to whether this represents a real change or merely a year-end flash in the pan. It is hard to tell at this juncture to what extent the current account and the capital account contributed to the improved showing in December. Higher exports played a part, and of course, the December surplus included the usual year-end interest and amortization payments besides large German prepayments for military supplies. There is some evidence of repatriation of corporate time deposits previously placed in Canada and Europe. On the other hand, bank term loans abroad appear to have risen sharply in December. In January, we seem to have shifted back into a deficit position, and emphasis on credit restriction in Europe will probably add to our difficulties over the coming months. Against this background it becomes all the more important to strengthen incentives for United States corporations to keep funds at home.

Bank credit increased strongly in December, on a seasonally adjusted basis, as loans other than security loans registered a very sharp spurt just before the year-end. Much of this increase may have been related to "special deals" made for tax purposes. Bank liquidity remains sufficient to cause the banks to seek loans aggressively, although the liquidity positions of banks outside of New York have come under greater pressure in the past year than those of New York banks. Despite the increasing pressure on banks in 1963 to dispose of U. S. Government securities, reflecting our policy changes of the last year or so, there has been no clear sign of a change in the underlying trend of total bank credit growth. In fact, money

supply plus time deposits grew even slightly faster in 1963 than in 1962. For the two years ending with the last quarter of 1963, total nonbank liquidity rose by 16.3 per cent, while in the same period gross national product at constant prices rose only by 8.5 per cent. There have been further substantial increases in both money supply and time deposits in January to date.

Over the past three weeks we have seen some slight degree of inadvertent ease in the money market attributable largely to unexpected movements in float. I am glad to see that it has been possible in the last few days to restore an atmosphere more in keeping with the Committee's directive. For the time being we are of course precluded by the Treasury's financing program from making any appreciable change in policy. I should also think we could appropriately leave the directive as it is.

Perhaps it is just as well that the Treasury's program gives us this occasion to sit back and await further clarification of economic developments, especially in the balance-of-payments area, before deciding whether a policy change is in order. Visibility should be a good deal better a few weeks from now. Looking ahead, however, I see some reason to question whether, even from a domestic point of view, we should encourage further growth of bank credit and nonbank liquidity at the rapid pace of the past two years. The cumulative pressure of liquidity may be posing a threat to the quality of credit. There is some evidence that credit is being channeled into undesirable uses and some signs that unsound lender practices are developing. Furthermore, the beginning of an upward creep in commodity prices may suggest the need for caution. Beyond this, of course, balance-of-payments developments must continue to weigh heavily in our policy judgments, and we shall have to keep a very watchful eye on credit policies in the other major industrial countries, which cannot help having significant effects on our own international accounts.

Mr. Shuford noted that, as the staff presentation this morning had indicated, over-all economic activity had risen in recent months, and perhaps a bit more than some had supposed. In addition, the balance of payments situation had shown real improvement. Real GNP increased at a 4.7 per cent annual rate from the second to the third quarter of last year and at a 6.3 per cent rate from the third to the fourth quarter.

Personal income rose somewhat more from June to December than in the first half of 1963. As also had been indicated by the chart show, these advances had all been made within the framework of relative price stability. These favorable factors were somewhat dampened by the less rapid increase in industrial production and employment since summer, and the continuing 5-1/2 per cent rate of unemployment.

The pace of economic activity in the Eighth District had moved up only moderately since mid-summer, Mr. Shuford said. Employment in the District's major labor markets had risen only slightly in this period, and the increases in industrial use of electric power and in bank debits had been moderate. However, business loans and bank deposits had both risen about 5 per cent since July.

His views on monetary policy, Mr. Shuford said, were about in line with those of Mr. Hayes. In light of the Treasury financing and of the uncertainties of the tax situation, he thought it would be well to make no change in policy, and wait and see. Bank reserves and the money supply had increased rapidly during the past few months, more than was desirable for any extended period. However, in the past few years reserves and money had expanded rapidly near the year end, and then more slowly in the early months of the following year. A similar pattern might be developing this year. If, however, the economy should continue to remain strong and to develop, and if monetary expansion did not moderate under the Committee's current policy, the Committee might have

to take steps to reduce the degree of ease. While he would rather not speculate on possible actions at future meetings, he did recognize that the recent rate of monetary expansion was high. He would suggest no change in the directive and no change in the discount rate.

Mr. Bryan said that there were few statistics available for the Sixth District that had not been reported previously. Most of the new figures were financial series. The total money supply was up almost 1 per cent in December, and the conventionally defined money supply was up about 1/2 per cent. Bank loans, and the total of loans and investments, were both up 1 per cent. A feeling of ease was evident at District commercial banks in January. Borrowing at the Reserve Bank had fallen back to the District's proportion of the national total or less, and District commercial banks had become net sellers of Federal funds.

Nationally, Mr. Bryan said, it seemed to him the business news was not exuberant despite optimistic forecasts. The direction was still upward, with a good many factors to his mind still being undetermined. Confidence seemed to be running high both in the District and in the nation. The new approach to the Federal budget might represent obeisance to conventional wisdom, but it seemed to contribute to the state of confidence. He thought the tax cut might have a surprisingly large effect, particularly through an investment feedback.

Mr. Bryan said that in preparation for this meeting he had reviewed the statistics on bank reserves for the past several years, and

he did not believe that the System could continue to supply reserves at the recent rate without producing an inflationary movement, some small signs of which he thought were already evident. Without trying to anticipate policy, he said, he believed the time was likely to come when the Committee would have to let free reserves drift downward toward a level of zero and perhaps even lower. He did not advocate a change in the discount rate at this time.

Mr. Bopp reported that the current picture of economic conditions in the Third District was brighter than usual--recognizing, of course, that levels of activity in some areas remained basically unsatisfactory. Recent movements in indicators of output, consumer sales, and labor force status all had been in the direction of increased demand and decreased unemployment.

At the same time, Mr. Bopp observed, the relaxing of reserve positions he had noted at the last meeting had continued. The basic reserve deficit of reserve city banks had declined, as had borrowing at the discount window by both reserve city and country banks.

Nationally, the imminence of a Treasury refunding and the absence of any significant new developments in the domestic and international economies indicated that policy should continue unchanged for the next two weeks, Mr. Bopp said. He would continue the present directive and discount rate.

He associated himself with those who could not foresee the future, Mr. Bopp continued. So he would underscore that part of the

President's Economic Report which stated that monetary policy must remain flexible, and he would agree particularly with the Report that, in addition to being able to move against inflation or a worsening in the balance of payments if these should occur, monetary policy also should be flexible enough to reinforce fiscal policy in promoting domestic expansion if this should prove necessary and feasible.

Mr. Thompson reported that once again, as in the recent past, current developments had been better than certain elements of doubt had led the Bank to expect. In the Fourth District, as in the nation, business in December was unusually good and outran expectations.

For example, despite fewer shopping days than usual in the Thanksgiving to Christmas trading season, retail sales reached record-breaking levels in December, scoring a 4-1/2 per cent gain over November, after adjustment for seasonal variation. Auto sales played an important role in the strong retail trade picture. The great strength in consumer spending, both in the District and in the nation, toward the end of the year helped to explain the sharp rise in the most recent estimate of GNP for the fourth quarter. Turning to the District's basic industry, steel output rose further in December, both locally and nationally.

Mr. Thompson said that the preponderance of the recent business news continued to point in the upward direction already indicated. But a familiar lack of tidiness appeared, insofar as some of the news failed to fit the pattern.

Figures on new car sales for the nation during the first two 10-day periods of January indicated that the sales pace had eased slightly from that of December. Although sales for the month were likely to be down slightly from earlier estimates, he still expected that the figures for January as a whole would set a record for the month.

In the steel industry, production had continued to expand in January. However, Mr. Thompson said, the Bank's private reports on new orders might be interpreted as contributing some elements of doubt regarding the rear-term future.

Insured unemployment in the Fourth District tended to increase more than seasonally between mid-December and mid-January, due to the effect of inclement weather on construction and other outdoor activities, as well as after-holidays layoffs in retailing and some plant shutdowns for inventory-taking. In summary, the strength in the Fourth District business picture appeared to reflect a moderate but consistent expansion in activity, and doubts appeared to reflect, at least in part, uncertainties arising out of the winter weather.

Mr. Thompson reported that trends in earning assets of Fourth District banks confirmed the picture of sustained business activity. In the three-week period ended January 15, the seasonal decline in earning assets of District weekly reporting banks was the smallest for the period in recent years. Although the net decline was centered in

loans, the total volume was unusually well maintained. Business loans declined only slightly and the volume of consumer loans remained unchanged. Term loans were continuing to rise and were now 12 per cent above a year ago.

Mr. Mitchell said that the staff report suggested, but did not prove, that the national economy had been performing well, and also that the balance of payments situation had improved and that prospects for it were good. The Committee seemed to be reduced at this meeting to speculating about future policy. He would go along with Mr. Bopp in saying that the Committee ought to make tomorrow's decisions tomorrow on the basis of the facts and insights that would be available then. Moreover, with a major shift in Federal tax policy impending, it was unthinkable to him for the System to make any change in monetary policy now. This was a time for watchful waiting--in particular, waiting to see what the effects of the tax cut would be. The Committee customarily abstained from policy changes at the time of Treasury financings, Mr. Mitchell noted, and he thought it should abstain also during a period when a tax cut was being considered, unless there was some outstanding development, evident to all, that required action. He saw no such development at present. Accordingly, he would make no change in policy, and no change in the directive.

Mr. Shepardson said he would agree, in light of all the circumstances that had been mentioned, that this was not a good time to move, and therefore he favored continuing present policy. However, he was concerned, from several different standpoints, as to what the future migtt

bring. When he read the news stories about the demands that were expected to be made in some of the forthcoming wage negotiations, he did not think the situation looked good. With respect to proposals for reducing overtime, if there was a lack of labor having particular needed skills, activity could be increased only by overtime work; additional people with the necessary skills simply were not available. He did not minimize the seriousness of the problem of unemployment, Mr. Shepardson said, but the expectation that employment could be found in areas for which unemployed people were not prepared was not borne out by facts.

With respect to recent monetary developments, Mr. Shepardson continued, it seemed to him that, for whatever reason, the Committee recently had provided a greater degree of monetary expansion than it had intended. The rate of increase in reserves supporting private deposits during the past six months was close to 8 per cent. This was more than "moderate" expansion, and more than he thought the Committee had contemplated when it shifted policy in the direction of less ease some six months ago. If his interpretation was correct, monetary expansion at this rate was building up the potential to support the inflationary forces portended by the forthcoming wage negotiations.

Mr. Shepardson made one final point: he thought the argument about unutilized facilities was greatly overdrawn. In his opinion, the recent expansion in activity had brought the level of utilization of economic facilities close to the optimum. To utilize the remaining

marginal resources would involve higher costs, and would consequently add to the pressures on prices.

Mr. Robertson said he agreed that the Committee could not decide now what it should do when the tax cut became effective. He then made the following statement:

> Obviously, bracketed as we are by Treasury financings, no change in policy should be made at this time. But we can profitably turn our minds to what factors ought to influence our choice of policy and methods once the Treasury refundings are past. In my comments at the last meeting I tried to describe what to my mind were the basic considerations that should guide our general choice of policy. Today I would like to say a few words about the specifics of our operating procedures.
>
> One particular consequence of our recent methods of operations has troubled me a great deal, and I know it is also worrisome to others around this table. That is the degree to which the market has been dominated by official actions and pronouncements. Partly this has been achieved by speech-making and the calculated "leak" of official attitudes, and partly by actual transactions in the market place. Operationally, the greatest influence in the longer-term sector has been the repeated blanketing of maturity areas by financing offerings, particularly advance refundings, along with heavy cushioning Treasury purchases whenever private investors appeared to be trying to move the market in a direction adverse to the chosen terms of such financings. System operations in coupon issues have fortunately never been as concentrated or as obviously directed at a rate objective as have the Treasury dealings; and so they have been less a contributor to official rate stabilization effects. But the sum total of these official influences can be seen in the indications of market performance. Dealer statistics suggest a concentration of private investor sales at times when official accounts are large buyers, with a corresponding thinning out of private selling activity in adjacent periods. Dealers also describe this effect qualitatively; they speak of the tendency for prospective sellers sometimes to hesitate closing deals at current prices, preferring instead to delay for a while in hopes of being able to unload on some future official buying orders. To a lesser extent, an analogous influence also seems at work on private buyers, leading them to delay buying in the market in the hopes of doing better in the next Treasury financing. The end result of all this, it seems clear, is a reduction

in the breadth, and depth, of the market for longer-term governments during the period between official actions.

In the bill market, too, the recent modus operandi has wrought its changes. Here the effects have not been so apparent in daily trading volume, which has been and continues to be very large, but in the behavior of interest rates directly. By such devices as timely additions to Treasury bill issues and sales from System and Treasury accounts, a fairly effective floor on the bill rate has been maintained for three years. Last November, official actions also put a ceiling on the bill rate, by simply reversing the techniques previously used to support the floor. While we have not resorted to the formal "peg" machinery of the wartime era, an informal pegging operation has succeeded in holding the bill rate within a very narrow band.

What has been the cost? I submit that we have significantly impaired the ability of the bill market to tell us which way underlying supplies and demands for short-term funds are moving. Last November, when the three-month bill rate scooted up to 3.58 per cent, we could not be sure whether a cyclical upsurge in credit demand was taking place or the market was simply reflecting its dismay that we and the Treasury were not actively fighting the dealer mark-ups in rates. Or, regarding the last several weeks, we cannot be sure whether the relative bill rate stability in the face of large dealer sales means that the dealers feel such bill demand is limited, or simply that they believe we will not let rates move much lower in any event. In effect, for policy purposes our vision has been impaired, and so has that of any other market participant who is trying to reach a decision to buy or to sell. Instead of the market being a window through which we can observe indications of private actions that might call for policy changes, we have made it--in part, at least--a mirror of our own intentions with respect to rates. And if we are honest with ourselves, we will admit that we do not really know, right now, quite how much of our current market evidence is "window" and how much is "mirror."

With all this said, I would not want to be construed as implying that we can or should aspire to a posture of no official influence on rates. Our basic policy actions clearly condition the viable range of market interest rates; this is true of cyclical changes in open market operations, reserve requirement and discount rate changes, and certainly the recent changes in Regulation Q. But precisely because these basic policy influences already do so much to condition market performance, we ought to be trying doubly hard to conduct our implementing operations so as to preserve as much as possible of the

market potential for reflection of private actions as well. Our vision at best is dim; to darken it still further makes our job that much harder.

Some may say that there are occasionally periods so critical that even a mild adverse market interest rate movement cannot be tolerated. I would not deny that such circumstances can arise, but I would emphasize as strongly as I can that rate stability at such moments is bought at a price, and that accordingly the costs as well as benefits ought to be weighed carefully and recurrently, for the cost in terms of impaired market communication and performance is a continuing and perhaps even a cumulative one, and it ought to be minimized whenever that can be done.

I think such an opportunity for restoring a greater measure of market responsiveness to private decisions lies immediately before us. With an improved balance of payments position, and a fairly lengthy period after mid-February free of Treasury financing needs, moderate market rate movements should now be less prejudicial to these two particular official concerns. We have had some slight rate fluctuations in some segments of the markets in the past two months, and these have been accompanied more recently by press inferences that perhaps officials would not object to somewhat greater rate oscillations. Thus, the market should not be too surprised if both we and the Treasury were now to embark on a zealous effort to refrain from the temptation to counter moderate and orderly rate fluctuations, either through open market or "open mouth" operations. If we could manage this endeavor, holding reserve availability a little more stable and money market rates a little less so, then I suspect we would find that market rates themselves would be a little more helpful in signaling when the next significant change in monetary policy should be considered.

Mr. Mills said that the so-called fiscal year of the Committee was approaching with the first of March. He would like to suggest to the Committee that it consider the language in the directives to the Manager of the System Open Market Account, and that thought preferably be given to reverting to the form of the directive that was customarily used in the years before 1961. He would make a statement that would

illustrate his reasons for the suggestion, which went back to both the form and substance of the directives. Mr. Mills then made the following statement:

The generally accepted purpose of Federal Reserve System monetary and credit policy has been to effect changes in the supply of reserves held at the disposal of the commercial banking system that would encourage the expansion or compel the contraction of bank credit and in so doing foster economic growth and stability. The directives issued to the Manager of the System Open Market Account were related to judgments regarding the supply of reserves as an instrument of broad economic policy and were not intended to focus on interest rates. Movements up or down of interest rates were regarded as a by-product of changes in the supply of reserves and not as a primary policy purpose.

Although the technical wording of the Federal Open Market Committee's current directives has not altered the sense of this time-honored purpose, maintenance of a specified interest rate structure has been the real goal of monetary and credit policy regardless of the changes in the supply of reserves that have been consequent upon its attainment. In result, fluctuations have occurred in the supply of reserves that in reality have signaled a change in monetary and credit policy that has not been recognized in the nondescript wording of the Committee's directives. For example, the wholesome increase engineered in the supply of reserves in recent weeks indicated a change in policy that has not been acknowledged in the directives.

This is a deplorable situation that must be remedied because members of the Committee have acceded to the wording of directives that have implied a different scheme of policy actions from those actually taken when adjustments were made in the supply of reserves. This divergence between the sense of the directives and positive policy actions assumed to have been taken to carry them out is contributing to public misunderstanding of the Federal Reserve System's policy objectives.

The root cause of these difficulties is, of course, the evil of a pegged market for U. S. Government securities and an artificial control over the interest rate structure that has stifled natural financial market interest rate responses to changes in the supply of reserves in the hands of the commercial banking system. As one member of the Federal Open Market Committee, it would be impossible for me to consider subscribing

> to the repetition of a policy directive hinged on "no change." Policy changes that have actually occurred, or are sought after, should be recognized in the directives and the members of the Committee thereby permitted to record their views and votes in accordance with the realities of the situation.

The Committee would note, Mr. Mills added, that his philosophy followed very closely the discussion and reasoning of Mr. Robertson. For the present, he believed that policy should in a sense lean toward ease in a way that would represent the more generous mechanical supplying of reserves that was evident in the last few reserve periods. Certainly, it would be a mistake to tighten policy at this period of the year before business plans were completely formulated. The economy deserved the stimulus that was implicit in the recent availability of credit.

Mr. Wayne reported that diversity continued to characterize Fifth District business conditions. Bank debits jumped sharply to a new high in December, and both nonfarm employment and factory man-hours made small net gains despite declines in some sectors. A somewhat slower pace, which might be partly seasonal in origin, had appeared in construction, lumber, and bituminous coal mining. Retail trade probably reached a record volume in December, and appeared to have declined less than seasonally in January. Mixed conditions were also reflected in the Richmond Bank's latest survey. Two-thirds of the respondents expected near-term stability while the other third anticipated further improvement. Survey returns from manufacturers were also mixed, Mr. Wayne reported,

especially with regard to new orders, backlogs, and shipments. Only one-third reported recent gains in new orders, about a third indicated no change, and the remaining third showed declines. Tobacco price support levels would be about 1 per cent higher in 1964, continuing the trend of the past few years.

As the economy completed its third year of growth and expansion, Mr. Wayne continued, it showed signs of substantial but uneven strength. Total retail sales appeared good for a normally dull period, and should remain strong in view of the anticipated tax cut. Expenditures for residential construction also had been moving up steadily to new high levels but future trends in this sector were subject to numerous doubts, as the staff presentation had noted. Unless prevailing signs were misleading, business investment, especially for new plant and equipment, would continue to improve for some months ahead. But there were some signs that automobile production and sales were leveling off after more than two years of high-level performance. In most other fields, however, there seemed to be no particular threat to continued moderate growth.

Mr. Wayne said that some recent price movements had been contradictory and puzzling, as Mr. Garfield had mentioned. A week ago several large aluminum companies had failed in their second attempt to achieve an industry-wide increase in the price of aluminum ingots. Recognizing, Mr. Wayne said, that Reynolds was one of the largest employers in the Richmond community, this had a much greater impact on

thinking that was warranted. About the same time, one steel company announced a reduction of approximately $20 per ton on three types of steel used largely in automobile production. But in four of the six weeks ending on January 14 the weekly index of wholesale prices moved up, the total rise being 0.8 per cent. He shared the concern of Mr. Hayes and Mr. Koch about possible price developments. In view of the increased activity and these conflicting movements in prices, Mr. Wayne said, it might be worthwhile to devote a little added attention to price trends in the next few weeks.

In the policy area, it seemed to Mr. Wayne that operations for the past three weeks had been appropriate to prevailing market conditions. Since there had apparently been no significant developments affecting basic economic and financial conditions, he saw no need for a revision of policy even if the Committee were entirely free to make a change. But since the Treasury would be heavily engaged in market operations for the next three weeks or so, the Committee was under obligation to refrain from any overt change. He would renew the present policy directive and leave the discount rate where it was. He joined Mr. Mitchell in the view that during the period of consideration of the tax bill the Committee should watch and wait unless there were overwhelming reasons for doing otherwise.

Mr. Clay reported that seasonally adjusted nonfarm wage and salary employment in the Tenth District rose at only about half the

national rate during the past year. Manufacturing employment, however, showed a percentage gain closely approximating the national average. In contrast with national developments, manufacturing employment in the District expanded significantly in the last half of the year. This followed a period of weakness extending from May 1962 to the summer of 1963 however.

Cash receipts from farm marketings in the Tenth District decreased 2 per cent last year compared with a 2 per cent increase nationally, Mr. Clay said. The substantially lower level of meat animal prices and the greater relative importance of meat animals in the District largely accounted for the less favorable performance in the District. This was further reflected in unofficial estimates that net farm income decreased more in the Tenth District than in the country as a whole.

It appeared that both livestock numbers and crop acreage in the District would be larger in 1964 than last year, Mr. Clay continued. However, moisture supplies were inadequate generally throughout the District as well as in other large areas of the nation. Farm income prospects for both the livestock industry and cash crops were dependent upon improvement in moisture conditions.

The report on the gross national product for the fourth quarter was very encouraging, Mr. Clay said. Considering all economic indicators and underlying conditions in major markets, it must be recognized,

however, that the basic problems confronting the economy remained much the same. All in all, it appeared to him that the appropriate thing to do at the present time was to await further developments and to continue monetary policy essentially unchanged. This would seem appropriate for domestic purposes and not incompatible with international considerations. It would also be in keeping with the Treasury refinancing activity during the period. Mr. Clay thought that the policy directive was satisfactory in its present form, and that the discount rate should be left unchanged.

Mr. Scanlon said recent evidence pertaining to the Seventh District tended to confirm the stronger business picture noted late in 1963. Retail sales continued strong in the first weeks of January and unemployment had been reduced somewhat further.

Two more Seventh District centers, Grand Rapids and Lansing, were classified in December as having "relatively low unemployment" (1.5 to 3 per cent), Nine of 23 major District centers were in this favorable position, Mr. Scanlon said, and there were only 17 labor markets in this class in the entire nation All of the District States estimated their unemployment rates to be lower than that for the U. S. Moreover, in each State the yearly average rate for 1963 was lower than for 1960.

Deliveries of U. S. cars to domestic customers equaled the record pace of a year earlier in the first 10 days of January, Mr. Scanlon noted. Production schedules called for 2.1 million cars in the

first quarter, which could raise inventories to the 1.2 million level in February or March--well above any previous record. The industry people with whom the Reserve Bank personnel visited indicated that higher inventories should be expected this year in view of the expiration of the labor contract in August and because of the larger number of models now offered. Nevertheless, he said, there appeared to be a fairly serious lack of balance in the current inventory. American Motors, apparently concerned about both the level and balance of inventories, would suspend production during the current week and resume at a lower rate on February 3.

Mr. Scanlon reported that manufacturers of machinery located in the Seventh District continued to report a good inflow of orders and to be optimistic about the year.

Over the last seven weeks, the December-January period, both loans and Governments at District weekly reporting banks increased less than a year ago, but more than in most other years, he noted. However, if security loans were excluded, net loan growth since the end of November had been greater than in the corresponding period of 1962-63. This was due to larger increases in borrowing by financial as well as commercial and industrial firms. Bank investments had increased slightly, mostly through bill purchases. There had been no marked change in reserve pressures, Mr. Scanlon said. The large Chicago banks had shown a moderate increase in net purchases of Federal funds and borrowings

over the past three weeks, but the latter was concentrated at one bank. Another large Chicago bank, which usually bought funds on balance, had been on the selling side of the market for the past three weeks.

As to policy, Mr. Scanlon said that in view of the Treasury refunding he would favor continuation of the present directive. He would not change the discount rate.

Mr. Deming said that "erratic" seemed to be the word that characterized economic behavior in the Ninth District during the past two or three months. Conditions had been sharply influenced by the weather, which had been unusually warm in the autumn, cold in December, and warm again in January.

At District banks, both loans and investments had been behaving about seasonally, with loans on the weak side of the seasonal pattern and investments on the strong side. Deposits were up quite sharply in recent weeks. Since mid-December, borrowings had been quite low. District banks currently were on the selling side of the Federal funds market.

Mr. Deming said that for reasons already advanced by others he would favor no change in policy during the next two weeks, no change in the directive, and no change in the discount rate.

Mr. Swan observed that there was little to add to the comments with respect to Twelfth District economic conditions that he had made three weeks ago. As in the country as a whole, the seasonally adjusted

rate of unemployment fell in December, even with a renewed decline in employment in defense and space related industries. However, the unemployment rate was still above a year ago. In the three weeks from Christmas to mid-January, loan demand in the District continued strong; loans at District weekly reporting banks increased, in contrast to a decline for the nation as a whole. In the first three weeks of January the major District banks were substantial sellers of Federal funds, but distribution of funds was uneven, and these sales were largely accounted for by one bank. In the week ending January 22, borrowing from the Reserve Bank by Twelfth District banks increased, while borrowing in the country as a whole dropped sharply. As a result, borrowing by Twelfth District banks was at the highest level in several months relative to the national figure.

Mr. Swan said he agreed that the Treasury financing precluded any change in policy at this point. Apart from the financing, however, he believed the continuing moderate nature of the business expansion, the relative degree of price stability, the shift in attitudes surrounding the Federal budget, the impending tax cut, and the improvement in the balance of payments all argued for continuation of present policy. He also agreed that while developments in the months ahead might require a policy change, there was no need to anticipate such a change at this time.

Mr. Coldwell reported that economic activity in the Eleventh District was following a normal seasonal pattern. Industrial production

had declined a little, apartment construction and other building continued high, and nonagricultural employment remained about the same. Perhaps the brightest spot in the District economy was the marked improvement in demand in the petroleum industry. However, there was a continuing trend toward consolidation and merger among oil companies. The agricultural situation was seasonally slack, and people were worried about the supply of moisture and about cattle prices.

Loan demand at District banks was reasonably strong, Mr. Coldwell continued, and bank investments had increased. Federal funds purchases were high, borrowing from the Reserve Bank was strong for this time of year, and the Reserve Bank was finding an increasing number of cases of reserve deficiency each month. Mr. Coldwell concluded by noting that many District bankers were unhappy about the disputes between the Federal Reserve and the Comptroller of the Currency.

Mr. Ellis said that economic conditions in the First District were about the same as he had been describing them at recent meetings. Retail sales were good and nonmanufacturing activity--particularly construction--continued strong. Manufacturing activity varied from no change to weakness, with nondurables in the latter category. The Reserve Bank's December auto instalment loan survey showed lengthened terms: 71 per cent of new car loans in the month, including both direct loans and purchased paper, were written with maturities of over 30 months, which in effect meant three years. A year ago the figure was 68 per cent.

With respect to monetary policy, Mr. Ellis said he agreed with Mr. Bopp on the need for flexibility. He also agreed with Mr. Mitchell that policy should not be changed during Treasury financing operations nor during debates on tax legislation in Congress. He thought the chart show today had been unusually good, and he concurred in the conclusion that a watchful eye on developments was particularly necessary now. He felt that price increases might provide the first sign that the rate of credit expansion had been, and currently remained, excessive relative to the rate that could be continued over the long term. In short, he shared Mr. Bryan's apprehensions. He agreed that the Committee should make no change in policy during this period of uneasy watching. He favored no change in the directive and no change in the discount rate.

Mr. Balderston said that he, too, favored maintaining the status quo until the next meeting. He would make only one point, and that was to suggest a concern that the present rate of economic expansion would come to a halt for reasons that were not now visible. During the last six quarters GNP had been rising at a rate that itself had been increasing. The rise in the third quarter of 1962 was .8 of 1 per cent, and that in the last quarter of 1962 was 1.5 per cent, quite a large figure. In 1963, the increases were at the following rates: 1.2 per cent in the first quarter, 1.4 per cent in the second, 1.6 per cent in the third, and 1.9 per cent in the final quarter. He did not know what would bring this pattern of rise to a halt but felt sure that something would; perhaps it would be the continuing increases in consumer and mortgage debt.

Chairman Martin said that Mr. Young had suggested that the Committee might want to make a minor technical change in the second paragraph of the policy directive, replacing the words "prospective Treasury financing" with the words, "an imminent Treasury refunding." He thought that the consensus today was clearly for no change in the policy, and he proposed that the Committee vote on a directive with no change other than in these few words.

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 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, and taking into account an imminent Treasury refunding, 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, Hayes, Balderston, Bopp, Clay, Mitchell, Robertson, Scanlon, Shepardson, and Shuford. Votes against this action: None. Abstaining: Mr. Mills.

Mr. Mills said that he would not vote to dissent from the directive but would like to abstain from voting. He could not fathom what the directive meant, and, as his statement had indicated, in recent weeks the directives and the actions implementing them had gone in opposite directions. He thought the Committee had lapsed into a state of euphoria that would not continue; a rude awakening from its "do nothing" position was due sometime.

Chairman Martin commented that he did not think Mr. Mills meant to imply that the Desk had not carried out its instructions, to which Mr. Mills responded that he could not pretend to understand the operations of the Desk. He thought the Desk had made an effort to carry out the instructions it had been given. But there was the problem that Mr. Robertson had mentioned and which he had echoed: if one changed the focus from an emphasis on adding to or withdrawing from the supply of reserves to an emphasis on the interest rate structure, one had a conflicting interest that posed a problem to the Account Manager that, he thought, the Manager would find insoluble.

Mr. Stone said that, as a technical matter, it would be helpful to the market if the bill rate did in fact fluctuate more than it had recently. He thought the major explanation of the recent stability in bill rates was a concern on the part of market participants that they would suffer punishing losses if rates moved too far. He would hope that the market would lose this fear.

There were several other factors that had to be taken into account in explaining the recent bill rate stability, Mr. Stone continued. One was that the degree of competition in the Government securities market had intensified substantially. There now were three more large dealers than there had been three years ago, and the new dealers were all able, active, and alert traders. The addition of these dealers had made the market even more competitive and had tended to reduce rate fluctuations in the market, he thought. A second, more fundamental, and still developing factor was the existence and growth of a large volume of short-term money market instruments that were regarded as substitutes for Treasury bills, and of a large number of aggressive and highly sophisticated participants in the market who moved funds back and forth among short-term instruments with great fluidity. In response to shifting interest rate differentials, they transferred large volumes of funds generated by their heavy cash flows among Treasury bills, bankers' acceptances, time certificates of deposit, commercial paper, and short-term issues of Government agencies. This had the effect of reducing the amplitudes of fluctuation in rates on all of these instruments.

A third factor was that some large banks were now adjusting their reserve deficiencies not through changes in their bill holdings but by changing their rates on time certificates of deposit by as little as 5 basis points. When banks first started issuing negotiable time

certificates, rate changes typically were 1/4 of a percentage point; a year ago, they were 1/8 of a point.

In sum, Mr. Stone said, the degree of unity in the money market had increased substantially. There always had been interconnections among money market instruments, but they were growing. The existence of both more short-term market instruments and of more sophisticated and aggressive market participants had contributed in a major way to the relatively narrow rate fluctuations in each of those instruments.

Mr. Mitchell asked what Mr. Stone had meant when he used the word "punishing" in reference to the apprehensions of market participants concerning bill rate changes. In reply, Mr. Stone observed that for about a year and a half before July 1963 there had been the problem of trying to keep the bill rate up in a context of ample reserves and a discount rate of 3 per cent. The bill rate was maintained largely because the Treasury made substantial additions to the market supply of bills. Given what the Treasury was doing, the Desk contributed some moderate additional influence in the same direction by resorting to certain technical devices in open market operations. For example, the Desk had tended to avoid the three-month area when buying bills, but when selling, it had sold three-month bills. Since mid-1963, however, resort to these devices in open market operations had been virtually eliminated; they had not been used in months.

In pursuing operations recently, Mr. Stone continued, the Desk had attempted to maintain the Federal funds rate at the discount rate much of the time. This had resulted in some member bank borrowing. Of course, the fact that the Federal funds rate was at the discount rate did not explain the stability of the bill rate; at times in the past when the Federal funds and discount rates were the same, the bill rate had fluctuated widely. The most important explanation of bill rate stability was one that Mr. Robertson mentioned--the fears of the market of actions by the authorities. But the other factors he (Mr. Stone) had cited also were important.

To respond specifically to Mr. Mitchell's question, Mr. Stone continued, there were occasions in 1961 and 1962 during which the bill rate was moving lower and dealers were acquiring inventories at rising prices, when the Treasury had come into the market with a strip of bills. Prices of bills had fallen, resulting in losses to dealers on the portfolios they had acquired at higher prices. This was a punishing experience for the dealers, and the market had begun to generate its own resistance to bill rate declines. Some dealers made it a practice to reduce their inventories whenever the rate tended down, thus limiting the decline.

Mr. Mitchell asked whether his inference was correct that the Committee could not change this situation without the cooperation of the Treasury, and Mr. Stone replied affirmatively. He added that the Treasury was, of course, aware of the problem.

Mr. Mills commented that he wished he had Mr. Stone's ability to describe an artificial market, and Chairman Martin observed that it appeared to him that the only way there could be a perfectly free market would be through complete nonintervention by both the Treasury and the System.

Mr. Stone said that in his opinion there was a broad, active, and viable market. The Desk recently had reviewed its experience in conducting operations, relating to the last four occasions on which it had sold Treasury bills and a similar number of occasions on which it had bought bills. The total volume of bids received from dealers ranged between $320 million and $530 million on the occasions when the Desk was selling, and the total volume of dealer offers ranged between $425 million and $675 million when the Desk was buying. Any market in which dealers were willing to do business on this scale at existing quotations was, in his judgment, a broad, active, and viable market. It was his conclusion that there had been no absolute impairment of the market, but he agreed that the market would be better if rate fluctuations were somewhat greater.

Chairman Martin noted that the Account Manager earlier had recommended renewal of the limitation specified in the continuing authority directive of $1.5 billion 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, and asked whether there were any objections. No objections were raised.

Chairman Martin then said that he would like to make a few comments on the hearings that were now under way before the Subcommittee on Domestic Finance of the House Banking and Currency Committee. The Subcommittee had requested that the Open Market Committee furnish its minutes for the years 1960-1963, inclusive. He proposed that this request be put on the agenda for discussion at the next meeting, and he solicited full consideration of the issue by the members in preparation for that discussion. One possible procedure would be to supply these minutes to the Subcommittee on the same basis as the 1960 minutes had been supplied to the Joint Economic Committee; that is, in confidence and not for public release. An alternative would be to refuse to supply the minutes, on the several grounds that had been employed in his letter to the Joint Economic Committee to support the statement that public release of the minutes would be unwise. If this latter course was chosen, the Subcommittee would have to subpoena the minutes in order to obtain them.

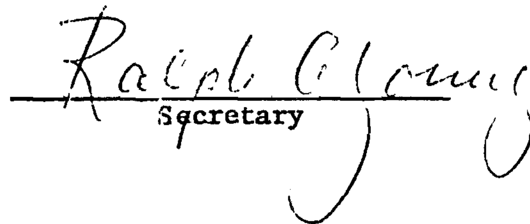
The Chairman thought that in due course the Open Market Committee would have to release more information than it had in the past, or, at least, to present information in a different form. He noted that differing points of view about publishing the minutes had been expressed in past discussions and that there had been quite a bit of disagreement when this subject was discussed at an Open Market meeting late last year. The Chairman did not think there was any great pressure on the Committee

with respect to this matter at present, but he expected that pressure would build up in the future. He urged everyone to think the matter through carefully and to be prepared to discuss it at the next meeting. He noted that the Committee might decide then to postpone a final decision until the following meeting in early March.

In a concluding comment, the Chairman said there was no question in his mind but that Mr. Patman was completely sincere in his views on the Federal Reserve System, and he thought everyone should approach the issues raised on that basis.

It was agreed that the next meeting of the Committee would be held on February 11, 1964.

Thereupon the meeting adjourned.



Secretary